Australian Government
Australian Accounting Standards Board

# Staff Paper

| | | | |
|---|---|---|---|
| **Project:** | **Not-for-Profit Financial Reporting Framework** | **Meeting:** | M214 |
| **Topic:** | **Redeliberation – Entity combinations** | **Agenda Item:** | 4.3 |
| | | **Date:** | 29 July 2025 |
| **Contact(s):** | Evelyn Ling<br>eling@aasb.gov.au<br>Maggie Man<br>mman@aasb.gov.au | **Project Priority:** | High |
| | | **Decision-Making:** | High |
| | | **Project Status:** | Project redeliberations |

## Objective of this paper

1 The objective of this staff paper is for the Board to decide how to finalise the proposed requirements exposed in ED 335 *General Purpose Financial Statements – Not-for-Profit Private Sector Tier 3 Entities* regarding Section 17 *Entity Combinations*.

2 The Board's decisions to date regarding the proposed other topics for address in a Tier 3 Standard are summarised in the Not-for-Profit Financial Reporting Framework project summary and in Agenda Paper 4.0.

## Structure of this paper

3 This paper is set out as follows:

(a) summary of staff recommendations – paragraph 4;

(b) background and reasons for bringing this paper to the Board – paragraphs 5 – 7;

(c) summary of the exposed Tier 3 requirements for subsidiaries, joint arrangements and associates – paragraphs 8 – 12;

(d) entity combinations: summary of feedback received – paragraph 13 and Table 1;

(e) entity combinations: analysis of stakeholder comments – paragraphs 14 – 16, including Table 2.

## Summary of staff recommendations

4 As set out in paragraph 16 below, staff recommend that the Board finalise, subject to any redrafting necessary to improve the clarity of the requirements, the Tier 3 requirements for entity combinations as exposed in Section 17 of ED 335, except as follows:

(a) regarding the date to recognise an entity combination:

(i) to require an entity combination to be recognised from the date of gaining control of the entity/ operating unit;

(ii) to include guidance that the "date of gaining control" may, where unclear, be a selected (i.e. estimated) date as long as this date is unlikely to result in a material difference to the financial performance and position of the entity; and

(iii) to require an entity to disclose the key judgements that the entity has made about the date it gains control of another entity/ operating unit, where these judgements have a significant effect on the amounts recorded in the financial statements.

(b) to amend paragraph 17.6 to clarify that an entity is not required to determine the fair value for all assets and liabilities in order to determine whether those assets or liabilities are material to the entity;

(c) to amend paragraph 17.7 to clarify that the exemption to measuring assets at fair value applies also to any acquired unrecognised donated non-financial assets for which the acquiree had not paid any consideration in exchange;

(d) to extend the exemption in paragraph 17.7 to include donated non-financial assets for which the entity paid a nominal or other significantly discounted amount, and which were originally measured at "cost". For the purposes of entity combination accounting, the carrying amount of the donated asset should be as though the Tier 3 Standard had always applied to the asset (for example, the "cost" of a donated building is subject to depreciation);

(e) to specify that an internally generated intangible asset acquired in an entity combination is not recognised; and

(f) to amend paragraph 17.8 to clarify that it is the acquiree's accounting policies that must be adjusted before the carrying amounts of the acquiree's assets, liabilities and items of equity are combined with those of the acquirer.

## Background and reasons for bringing this paper to the Board

5 The Board decided at its 1 May 2025 meeting to proceed with developing a Tier 3 Accounting Standard with simplified recognition, measurement, and disclosure requirements for smaller not-for-profit (NFP) private sector entities, and commence redeliberations of the proposals in ED 335.[1]

6 At the May 2025 board meeting, the Board considered the summarised feedback on ED 335 and a proposed categorisation of the extent of the Board's re-deliberation efforts. This paper presents the staff analysis and recommendations for the identified Category B topic pertaining to the accounting for entity combinations (business combinations). The Category B topics are proposals where stakeholders provided mixed feedback or expressed substantive concerns on one or more particular aspects of the proposals.[2]

7 The primary objective of this paper is for the Board to, in respect of the topic covered, decide whether to make any substantive changes to the proposals exposed in ED 335. Staff have not included any revised drafting in this paper. Consistent with the approach taken to the redeliberated topics to date, staff plan to present the revised drafting collectively in November 2025, as per the project timeline outlined in Agenda Paper 4.0. This approach will allow the Board to first consider all decisions on matters of principle, ensuring a comprehensive view of the overall draft Standard.

## Summary of the exposed Tier 3 requirements for subsidiaries, joint arrangements and associates

8 The proposals for the accounting for subsidiaries, joint arrangements and associates are primarily specified in Section 8 *Notable Relationships and Consolidated and Separate Financial Statements*, Section 13 *Investments in Associates and Joint Arrangements* and Section 17 *Entity*

1 Per minutes of the 1 May 2025 AASB meeting

2 Refer Agenda Paper 4.2 of the 1 May 2025 AASB meeting for the categorisation of topics as Category A and Category B.

*Combinations* of the draft Tier 3 Standard (ED 335). For ease of reference, the summarised requirements set out in paragraphs 9 – 12 below are repeated in Agenda Papers 4.2 and 4.4.

9 At a high level, ED 335 made the following key proposals regarding the accounting for subsidiaries, joint ventures and joint operations, and associates:

(a) subsidiaries, joint ventures and joint operations, and associates may be treated as a single class of assets ('investments in notable relationship entities'). This class of assets must be measured at cost, fair value, or using the equity method of accounting in the financial statements of the entity (paragraph 8.5 of ED 335).

As the investments are treated as a single class of asset, it follows therefore that the only assessment of ownership interest that is required is whether or not the holding represents at least an interest in an associate (i.e. at least significant influence in that other entity) vs. an ordinary financial asset. It is not necessary for the investor (the reporting entity) to further consider whether its interest in the acquired entity is that of control or joint control;

(b) alternatively, subsidiaries, joint ventures and joint operations, and associates may be treated as separate classes of assets. In these instances, as per Tier 1 and Tier 2 reporting requirements, the entity must determine whether its interest is that of control, joint control, or significant influence. ED 335 then directs that:

Where the reporting entity is a parent

(i) consolidated financial statements must be presented, in which subsidiaries must be consolidated (paragraph 8.12 of ED 335) and associates and joint ventures measured using the equity method of accounting (paragraph 13.12 of ED 335). The entity recognises its share of any jointly controlled assets, liabilities, revenues and expenses of its interests in a joint operation (paragraph 13.19 of ED 335); and

(ii) when separate financial statements are presented together with the consolidated financial statements, these subsidiaries, associates and joint ventures are measured, by class, at either cost, fair value, or using the equity method of accounting (paragraph 8.37); and

Where the reporting entity is not a parent (i.e. there are no subsidiaries)

(i) associates and joint ventures are measured respectively at either cost, fair value, or using the equity method of accounting (paragraph 8.37). The entity recognises its share of any jointly controlled assets, liabilities, revenues and expenses of its interests in a joint operation (paragraph 13.19 of ED 335); and

(ii) when separate financial statements are presented together with those financial statements (e.g. in addition to equity-accounted financial statements), associates and joint ventures are measured respectively at either cost, fair value, or using the equity method of accounting (paragraph 8.37).

10 The proposed disclosures for subsidiaries, associates and joint arrangements depend on whether the investments are treated as a single class (notable relationship entities) or as separate classes of assets. Section 13 contains no specified disclosures for joint operations.

11 At a high level Section 17 of ED 335 made the following proposals about the acquisition of a subsidiary in consolidated financial statements, and for other entity combinations:

(a) the carrying amounts of the assets, liabilities and items of equity of the entity to be combined, adjusted to conform with the reporting entity's accounting policies, and the fair values of material assets and liabilities that do not have an existing carrying amount recorded in accordance with Australian Accounting Standards, are to be recognised at the 'deemed combination date'. The deemed combination date is the beginning of the reporting period during which the entity combination occurred (paragraphs 17.5, 17.6 and 17.8 of ED 335); and

(b) any difference between the carrying amount of the consideration paid and the carrying amount of the net assets recorded in the combination is recognised directly in equity (paragraph 17.7 of ED 335).

12 In relation to the equity method of accounting, at a high level, the equity method proposed in ED 335 is largely consistent to that specified by AASB 128 *Investments in Associates and Joint Arrangements*. However, there are several key differences:

(a) consistent to the book value method proposed for subsidiaries, the investment is measured on Day 1 at the investor's share of the carrying amounts of the net assets of the investee. This may be different to the consideration paid for the investee, and is the result of the interaction between paragraph 13.16 and 13.16(c) of ED 335;[3]

(b) the consideration/transaction price of the acquisition is measured by reference to the carrying amounts of the investor's net assets given up in exchange (i.e. book values of the buyer), rather than their fair values (refer paragraph 13.16 of ED 335);[4]

(c) the difference between the transaction price[5] and the investor's share of the carrying amounts of the net assets of the investee is recognised directly in equity (paragraph 13.16(c) of ED 335);[6] and

(d) while an investor should adjust the financial statements of the investee to reflect the effect of different accounting policies, it need not do so if this would be impracticable (paragraph 13.16(g) of ED 335).

## Entity combinations: Summary of feedback received

13 Specific Matter for Comment (SMC) 25 in ED 335 sought stakeholder views regarding the proposed accounting for entity combinations in Tier 3-compliant general purpose financial statements. Per Agenda Paper 4.3 of the 1 May 2025 Board meeting, of the 18 comment letters that responded directly to ED 335 and the total participants who attended a virtual/ in-person outreach session, 10 submissions and 19 respondents provided a response to SMC 25. Table 1 below provides an overview of the responses received.

*Table 1: SMC 25 responses*

| | **Agreed** | **Agreed with exception** | **Disagreed** | **Unsure** |
|---|---|---|---|---|
| Out of 10 comment letters that commented on SMC 25 | - | 10 (100%) | - | - |
| Out of 19 participants who attended a virtual/ in-person outreach session and commented on SMC 25 | 11 (58%) | - | 2 (10%) | 6 (32%) |

3 In contrast, AASB 128 and the *IFRS for SMEs* specify that the investment is initially measured at its transaction price (including transaction costs). The initial measurement is increased by the amount of any gain on bargain purchase so that the investment reflects the investor's share of the fair value of the net assets of the investee.

4 That is, under the proposals, if a fully depreciated asset were transferred as payment for ~~the~~ an associate, the transaction price/ consideration paid for the acquisition would be $nil.

5 Staff think the reference to transaction price in paragraph 13.16(c) should have been to the consideration paid, consistent with 13.16. Staff intend to review this drafting in the revised draft Standard (expected November 2025).

6 In contrast, AASB 128 and the *IFRS for SMEs* calculate any goodwill or gain on bargain purchase by reference to the fair values of the net identifiable assets of the investee, and require a gain on bargain purchase to be immediately recognised in profit or loss. Under the *IFRS for SMEs*, any goodwill is amortised over its useful life, and subject to impairment.

## Entity combinations: Analysis of stakeholder comments

14 As noted in Table 1, while a majority of stakeholders responding on this topic agreed with the Board's proposals in ED 335 regarding the accounting for entity combinations, most stakeholders expressed concern or uncertainty with one or more aspects of the proposals. Their concerns and comments are summarised and analysed in Table 2 below, and include concerns about the measurement of donated non-financial assets acquired as part of an entity combination. Staff note that the measurement of donated assets is also discussed in Agenda Paper 4.1 and that the Board decisions in that paper may impact the Board decisions regarding the accounting for entity combinations:

*Table 2: Analysis of stakeholder comments*

| Stakeholder comments | Staff analysis |
| --- | --- |
| ***Date of the combination*** | |
| 1. Six stakeholders (3 professional services firms, 1 other and 1 professional body) disagreed with the deemed combination date being the beginning of the reporting period during which the combination occurred, as it would mean combining entities when there was no control of the other entity/business. Similarly, many stakeholders in outreach sessions expressed concerns about the deemed combination date proposal; considering that establishing the combination as having occurred at the start of the current period could potentially lead to numerous assurance challenges and manipulation of accounts. This is because it would involve consolidating activities when control was not yet established, and access to financial | Staff note that the Board's preliminary view exposed in the predecessor Discussion Paper to ED 335 was for entities to apply AASB 3 *Business Combinations*: as such, the feedback informing its ED 335 proposals did not include comment on the use of a deemed combination date. Basis for Conclusions paragraph BC98 to ED 335 reflects that the Board decided to propose that the combination date should be deemed to be the beginning of the reporting period in which the entity combination occurred as a simplification for entities, responding to the heard challenges and costs of identifying when control of an acquiree is obtained.<br><br>In developing its proposals exposed in ED 335, the Board did not specifically consider the arguments raised by stakeholders on the left hand side of this row against the use of the beginning of the reporting period as an appropriate date from which to account for the entity combination (and resultingly, to consolidate the acquired entity or operation from that time). The Board's considerations were more focused on providing entities with a way of circumventing the concern that a NFP entity might not necessarily know exactly when control of another entity/ operating unit was obtained.[7]<br><br>Having regard to the stakeholder feedback, staff have identified the following alternative actions the Board could take in progressing development of a Tier 3 Standard:<br><br>(a) Action A: Finalise the deemed combination date proposal as drafted;<br><br>(b) Action B: Establish the <u>beginning of the month of acquisition</u> as the deemed combination date; or |

7 The Board discussed its proposals for entity combinations primarily at its 6-7 June 2024 meeting (Agenda Paper 3.2 of that meeting) and at its 5-6 September 2024 meeting (refer Agenda Paper 3.10 and Agenda Paper 3.12 of that meeting (supplementary materials)). Some aspects of the proposals were developed or further developed/refined by the Board's drafting subcommittee in between these two AASB meetings and presented to the Board at its September 2024 meeting.

| Stakeholder comments | Staff analysis |
| --- | --- |
| records before obtaining actual control might be limited.<br><br>These stakeholders considered the proposal would present practical issues such as not having information to support transactions included within the NFP before the effective date of the combination.<br><br>These stakeholders also considered those charged with governance may not be willing to authorise financial statements containing information for an entity/business the reporting entity did not govern during the pre-combination period. One of the firm's experiences is that financial distress is often a driver of a combination, and that including possible operating losses of another entity prior to the actual combination would be misleading to users.<br><br>Some of these stakeholders also noted that including pre-combination assets would not meet the definition of resources controlled by the entity under the *Conceptual Framework*, and observed that paragraph 17.5 of ED 335 contradicts paragraph 8.28 of the ED which requires income and expenses to be recorded only for the period of control.<br><br>Some stakeholders proposed alternative approaches for consideration. These were to: | (c) Action C: Require an entity combination to be recognised from the date of gaining control of the entity/ operating unit, but support preparers by developing Tier 3-specific guidance to communicate that the “date of gaining control” may, where unclear, be a selected (i.e. estimated) date as long as this date is unlikely to result in a material difference to the financial performance and position of the consolidated entity. In conjunction with this, highlight that paragraph 7.8 of ED 335 might require the entity to disclose the key judgements the entity has made about the date it gains control of another entity/ operating unit and from which it accounts for the entity combination (and consolidates any subsidiary), where the date of the entity combination is subject to judgement and could have a significant effect on the amounts recorded in the financial statements. The proposed guidance could be situated either within (‘grey text’) or accompanying (application guidance) a Tier 3 Standard.<br><br>In developing the alternative actions above, staff considered and rejected some of the proposed alternative approaches suggested by stakeholders because staff considered the approach would introduce too much variability in establishing the date of control or allow the manipulation of results.<br><br>*Analysis of Action A:* The Board might finalise the deemed combination date proposal as exposed, if the Board considers that the benefits of the simplification will continue to exceed its costs (including the costs highlighted in the stakeholder objections).<br><br>However, staff do not support Action A given the reasons for, and extent of, stakeholder objection for the proposal. In particular, staff:<br><br>(a) agree that the resulting financial statements may not faithfully represent the financial performance and financial position of the entity;<br><br>(b) are of the view that consistency with the *Conceptual Framework for Financial Reporting* should be prioritised where possible – this includes the recognition of assets and liabilities only when an entity has gained control of those assets and assumed responsibility for those liabilities; and<br><br>(c) observe that the proposed deemed combination date approach could be challenging to apply to acquisitions of an operating unit or net assets (rather than an equity interest in another entity), such that the objective of the simplification is not achieved. |

| Stakeholder comments | Staff analysis |
|---|---|
| (a) require the combination to be accounted from the effective date of gaining control;<br><br>(b) develop a practical expedient to permit entities to adjust the combination date by no more than 16 days (either before or after the combination date) to the beginning or end of the month of acquisition as long as no material events have occurred in the acquiree in that period. The stakeholder considered that this approach would allow entities to collect information to a month end rather than mid-month, and if no material events have occurred it is unlikely to result in material differences from recognising the combination at the actual acquisition date;<br><br>(c) where the transfer date is unspecified – use the start of the reporting month if there are no material transactions;<br><br>(d) use the acquiree's last set of accounts only if the actual combination occurred within one to three months from the deemed combination date;<br><br>(e) use an estimated acquisition date of control. The stakeholder noted this | *Analysis of Action B:* This action continues to require the use of a deemed combination date, but amends the proposed deemed combination date to a date closer to the actual time of the combination.[8] This action continues to view the benefits of the simplification to exceed its costs, as by changing the proposed deemed combination date the 'new' costs highlighted by the stakeholder feedback are arguably mostly alleviated. This action recognises, per the stakeholder suggested approaches, that a date closer to the actual time of the combination is less likely to result in material misrepresentations of the financial performance and position of the entity.<br><br>However, staff do not support Action B in preference to Action C for the reasons given in the staff analysis to Action A and for the below reasons:<br><br>(a) this approach prioritises the practical rather than being principles-based; and<br><br>(b) while it goes some way to addressing the stakeholder feedback received, some of the stakeholder concerns about the use of a deemed combination date remain (e.g. access to financial records, whether those charged with governance are willing to authorise financial statements that include the results for an entity/business the reporting entity did not control).<br><br>*Analysis of Action C:* This action recognises the Board's reasons for proposing the original simplification but acknowledges the stakeholder concerns about assurance challenges and an entity's ability to obtain information and authorise results. It allows the use of a date that varies from an "actual" date of gaining control, but relies on the concept of materiality to support this departure. Advantages of Action C include:<br><br>(a) better alignment to the *Conceptual Framework for Financial Reporting* and Tier 1/ Tier 2 reporting requirements (recognition when control is gained);<br><br>(b) internal consistency with the proposals in Section 13. Section 13 does not reflect that entities may face similar challenges in establishing the date of gaining significant influence or joint control over another entity;<br><br>(c) it is easier to apply to entity combinations that do not involve the acquisition of shares of another entity; and |

8 The choice of the beginning of the reporting period as the deemed combination date is consistent with UK Financial Reporting Standard FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland* (reissued September 2024). Staff note that in developing the ED 335 proposals, staff did not identify the use, by another jurisdiction, of an alternative date to this as the deemed combination date of a combination/ group restructure – including that proposed in Action B.

| Stakeholder comments | Staff analysis |
|---|---|
| would likely be subject to audit scrutiny; or<br><br>(f) allow an entity to select a date or use a date where it is clear that control exists. | (d) potentially lower costs of training preparers/practitioners and educating users (as the requirements are more consistent with Tier 1/Tier 2 reporting requirements).<br><br>However, while remaining a simplification from Tier 2 reporting requirements, staff note that Action C might be more complex to apply than the other suggested Actions, and so, could be more costly to apply. The following aspects of the proposals give rise to more costs compared to the other possible Actions:<br><br>(a) Action C requires the exercise of more professional judgement especially in instances where the date of gaining control is not clear, as preparers must identify an appropriate date that satisfies both the condition that control is present and that it is unlikely to result in any material difference (when considered against the suite of other possible dates);<br><br>(b) preparers may find it difficult to articulate, as specified by paragraph 7.8 of ED 335, the key judgements they have made about determining an estimated date of control in the process of applying the entity's accounting policies; and<br><br>(c) in instances where the date of gaining control is not clear, obtaining auditor agreement about the date to apply entity combination accounting will necessarily involve more resources (time and monetary cost).<br><br>Staff note that the additional costs that might be suffered require management to take ownership of the results and financial position of the reporting entity. Consequently, having regard to the above analysis, on balance, **staff recommend** Action C as staff think this Action best acknowledges and addresses the concerns raised. That is, staff recommend the Board amend the requirements exposed in Section 17 of ED 335 to specify that:<br><br>(a) an entity combination is to be recognised from the date of gaining control of the entity/ operating unit;<br><br>(b) the "date of gaining control" may, where unclear, be a selected (i.e. estimated) date as long as this date is unlikely to result in a material difference to the financial performance and position of the entity; and<br><br>(c) where paragraph 7.8 applies, an entity must disclose the key judgements that the entity has made about the date it gains control of another entity/ operating unit. |
| ***Requirement to measure certain assets and liabilities at fair value*** | |
| 2. Two stakeholders (professional bodies) considered that paragraph 17.6 of ED 335 presumes Australian Accounting Standards | It is not possible that both combining entities do not apply Australian Accounting Standards. Staff note that under the proposals, the reporting entity (acquirer) at least will prepare Tier 3-compliant general purpose financial statements and as such, will apply Australian Accounting Standards. Then, paragraph 17.6 requires |

| Stakeholder comments | Staff analysis |
| --- | --- |
| have previously been applied or that fair value measurement is available for assets and liabilities of the combining entities. These stakeholders observed that there can be instances where neither criterion is met for the combining entities. As such, these stakeholders considered that further accounting requirements and guidance should be developed to address such scenarios.<br><br>(Staff note that this stakeholder suggested that Section 17 include a description of "an entity" – refer stakeholder comment #11 below) | that where the carrying amounts of the acquiree's assets and liabilities were not determined in accordance with Australian Accounting Standards, these shall be recognised and initially measured by the acquirer at their fair values (an exception for donated non-financial assets applies). The fair value measurement is as of the combination date, and not of a historical point in time.<br><br>Having regard to the above, staff consider that further accounting requirements and guidance do not need to be developed in response to the stakeholder comment. **That is, staff recommend** making no change to ED 335 in direct response to the stakeholder comment.<br><br>However, on reflection, staff think that this stakeholder concern, considered together with their other comment about clarifying "an entity", suggests that the drafting of Section 17 might need to be amended to provide better clarity regarding the proposed requirements. Staff intend to review and revise the drafting of Section 17 for editorial and other minor amendments and will bring our proposed amendments in this regard to a future Board meeting for the Board's consideration as part of a draft Standard (expected November 2025). |
| 3. Two stakeholders (1 professional services firm, 1 other) disagreed with the proposal to require assets and liabilities without a carrying amount that is recognised in accordance with Australian Accounting Standards to be initially measured at their fair values, and recommended the requirement be removed, for the following reasons:<br><br>• the acquiree might not have kept sufficient accounting records to allow for donated vs non-donated asset information to be obtained;<br><br>• where such information is not available, there is a risk that the auditor might | Staff note that the requirement in paragraph 17.6 of ED 335 was proposed as the Board was concerned that some assets and liabilities held by the acquired entity/ operating unity might not have been recognised by the acquired entity prior to the combination (refer paragraph BC97 of ED 335). As such, this requirement would likely only relate to, and apply, in instances where the acquired entity does not prepare financial statements (or keep accounting records) that comply with Australian Accounting Standards. Because of this, the carrying amount – if any – of the assets and liabilities of that acquired entity cannot present a suitable base from which to incorporate the entity/ operating unit into the acquirer's financial statements.<br><br>Staff concur that it may not always be clear whether certain assets held had been donated to the entity or not, and that there may be a need to improve an entity's record-keeping about its assets. However, staff think that these costs do not appear to be so sufficiently significant so as to cause the Board to revisit its decision to require material assets and liabilities without a carrying amount to be initially measured at their fair values. Staff also note that the decision to provide an exemption from fair value measurement for certain donated assets was not a comment on their information value, but rather made in order to align the entity combination requirements with the Board's proposals elsewhere in the Tier 3 Standard.<br><br>Nevertheless, in light of the stakeholder feedback, staff considered what an appropriate alternative to fair value measurement might be. A viable basis to measuring such assets that is not a current value |

| Stakeholder comments | Staff analysis |
|---|---|
| issue a modified opinion that the entity is not able to remediate;<br>• effort is required to maintain track of donated assets;<br>• requiring (non-donated) assets recorded at a $nil deemed cost in a legacy period, and other assets, to be initially recognised at their fair values implicitly concludes that the information value of these assets differs to those of donated assets. The stakeholder making this comment considered that the requirements that apply to donated assets suggest that the information content of that fair value information is not material to users when compared to the costs of obtaining that information;<br>• the proposals are inoperable as either (1) assets and liabilities at $nil carrying amount are immaterial and therefore a requirement to measure the assets and liabilities at fair value never applies, or (2) they require an entity to determine the fair value for all assets and liabilities in order to determine whether those assets or liabilities may be material to the entity. | measurement basis might be the combination date carrying amount of the asset/ liability determined as though Australian Accounting Standards had always applied to those assets and liabilities. However, such requirement is arguably more costly to action than requiring material assets and liabilities to be measured at their fair values (with an exception for donated assets). Further, staff observe that the entities subject to the combination can already achieve this outcome if they wish to avoid fair value measurement, by the acquiree entity applying the Tier 3 Standard (or Tier 1/ Tier 2 reporting requirements) ahead of the combination event.<br><br>Staff also note that the Board did not intend to impose a requirement for the acquired assets and liabilities to all be fair valued for the purposes of determining which items needed to be recorded at fair value in applying entity combination accounting. However, on reflection, staff note that paragraph 17.6 of ED 335 as drafted might suggest such action is necessary. As such, staff think the stakeholder concern could be addressed through amend of the drafting, rather than reject of the proposed requirement, for example, by either (1) removing "material" from the text – consistent with how other requirements do not specifically say that the requirement is applicable only where material, or (2) replacing "material" with another word such as "major".<br><br>Having regard to the above, **staff recommend** making no change to the proposed fair value measurement requirements in paragraph 17.6 but to amend the text to clarify that an entity is not required to determine the fair value for all assets and liabilities in order to determine whether those assets or liabilities are material to the entity. |
| 4. A stakeholder (regulator) disagreed with the proposal that acquired donated non- | As noted in Basis for Conclusions paragraph BC97 of ED 335, the Board's intent in making the proposal in paragraph 17.7 was to align its entity combination accounting requirements with its proposals regarding |

| Stakeholder comments | Staff analysis |
| --- | --- |
| financial assets may be measured at cost ($nil) at the combination date, consistent with their general objection to the measurement proposals for donated assets (refer Agenda Paper 4.1). | donated assets. The absence of this requirement could otherwise impose disproportionate measurement obligations on the reporting entity.<br><br>Noting the above, and having regard to the majority support for the proposal, **staff recommend** making no change to the proposed requirements in response to the stakeholder comment. |
| 5. A stakeholder (professional services firm) observed that paragraph 17.7 appears to require that the donated non-financial asset must have been measured at cost in accordance with specified paragraphs of the Tier 3 Standard before relief from fair value measurement is available.<br><br>Relatedly, another stakeholder (other) observed that the scope of paragraph 17.7 of ED 335 refers to donations received without paying any consideration in return: this appears to exclude assets acquired for nominal consideration and thus require them to be measured at fair value. | Paragraph 17.7 of ED 335 states "If a combining entity was donated a non-financial asset before the entity combination without paying any consideration in return and elected to initially measure that asset at its cost (nil) in accordance with paragraph[s] … the donated asset is excluded from the application of paragraph 17.6". Paragraph 17.6 requires the acquirer to measure the acquired material assets and liabilities that do not have an existing carrying amount recorded in accordance with Australian Accounting Standards at their fair values.<br><br>Basis for Conclusions paragraph BC97 of ED 335 suggests that in forming its proposal in paragraph 17.6 and 17.7 of ED 335, the Board was primarily concerned about <u>unrecognised</u> assets held by the acquired entity. As noted in paragraph BC97, the Board's intent in making the proposal in paragraph 17.7 was to align its entity combination accounting requirements with its proposals regarding donated assets. The donated asset proposals allow a Tier 3 entity to recognise the donated asset at its cost rather than fair value, and contemplate that an asset might be donated even though some consideration might be transferred in exchange for the asset, as cost is identified as being nil, a nominal amount or another significantly discounted amount.<br><br><u>Donations for nil consideration</u><br><br>Staff concur with the stakeholder comment that paragraph 17.7 as drafted appears to exclude donated non-financial assets held by an acquiree that does not comply with Australian Accounting Standards. This is because the asset may not have been recognised because it was received for free (for example, under cash accounting), or because the acquiree had not explicitly applied the accounting policy specified by the Tier 3 Standard to account for that asset at its cost.<br><br>Staff think that this was not the Board's intent, as indicated by paragraph BC97 to ED 335. Consequently, **staff recommend** amending paragraph 17.7 to clarify that the exemption to measuring assets at fair value applies also to any acquired unrecognised donated non-financial assets for which the acquiree had not paid any consideration in exchange. |

| Stakeholder comments | Staff analysis |
|---|---|
| | <u>Donations for some consideration</u><br><br>Staff note that if the acquired entity/operating unity had complied with Tier 3 (or Tier 1/Tier 2) recognition and measurement requirements for donated assets, and initially recognised at cost those donated assets for which <u>some</u> consideration had been paid – these assets are within the scope of paragraph 17.6 and are recognised at their carrying amounts.<br><br>However, staff note that it is possible that the reporting entity acquires an entity that holds donated assets originally measured at the nominal or other significantly discounted amount paid for the asset, but thereafter does not comply with the recognition and measurement specified by Australian Accounting Standards. Staff concur with the stakeholder comment that paragraphs 17.6 and 17.7 of ED 335 as drafted would appear to require such donated assets to be measured at fair value.<br><br>Staff think the Board should take one of the following actions in response to the stakeholder feedback:<br><br>• Action 1: Make no change to the scope of the proposed requirements (only donations received without paying any consideration in return are exempted from fair value measurement); or<br><br>• Action 2: Extend the exemption to include donated non-financial assets for which the acquiree paid a nominal or other significantly discounted amount, and which were originally measured at "cost". For the purposes of entity combination accounting, the carrying amount of the donated asset should be as though the Tier 3 Standard had always applied to the asset (for example, the "cost" of a donated building is subject to depreciation).<br><br>Staff note that Action 1 potentially imposes an onerous burden on entities, and that it significantly differentiates the treatment of assets of a similar nature. Therefore, having regard to the intent of the Board in developing the exemption in paragraph 17.7, **staff recommend** Action 2. |
| 6. A stakeholder (other) suggested that paragraph 16.6 of ED 335 relating to intangible assets obtained in an entity combination should be moved or at least cross-referenced to Section 17, as it involves an exception to the recording and measurement principles of paragraphs 17.5 – 17.9, (that is, as intangibles would | Staff think that the operation of Section 17 and paragraph 16.6 is clear, and that paragraph 16.6 is not an exception to the recognition and measurement principles of paragraphs 17.5 – 17.9 but merely a cross-reference to the requirements that apply to intangible assets acquired in a business combination. Therefore, paragraph 16.6 should not be relocated as suggested. No further cross-reference is necessary as paragraph 16.6 already includes a cross-reference to Section 17. |

| Stakeholder comments | Staff analysis |
|---|---|
| generally have a nil carrying value, that nil value is retained rather than being fair valued). | Also, staff consider that intangibles that have a nil carrying value would not always be initially measured at that $nil value rather than being fair valued when applying entity combination accounting. Paragraphs 17.5 – 17.9 explain that an (non-donated) intangible asset that had been:<br>• externally acquired by the acquiree and recorded in accordance with Australian Accounting Standards – must be initially measured at its carrying amount. This might include instances where the asset's original cost is $nil and where the carrying amount is a fully amortised amount of $nil;<br>• externally acquired by the acquiree and recognised but not recorded in accordance with Australian Accounting Standards (for example, the asset is not amortised nor considered for impairment) – must be initially measured at its fair value; or<br>• not recognised by the acquiree before the combination (for example, because it was an internally generated item and not recognisable as an asset per Tier 3 reporting requirements, or failed Tier 3 capitalisation criteria, or because the entity has a policy of expensing all spend on intangible assets) – must be initially measured at its fair value.<br>Consequently, **staff recommend** making no change to the proposed requirements in response to the stakeholder comment.<br><br><u>Further Board direction required: Acquired internally generated intangible assets</u><br>As noted above, some internally generated intangible assets might not be recognised by the acquiree before the combination. This might be due to the application of Australian Accounting Standards; for example, paragraph 16.7 of ED 335 requires all expenditure on internally generated items to be written off as incurred rather than capitalised. Alternatively, it might be because the acquiree has a policy of not recognising such assets in its special purpose financial statements.<br>On occurrence of an entity combination and similar to AASB 3 *Business Combinations*, 'new' intangible assets relating to those formerly expensed amounts may arise as the definition of an intangible asset in paragraph 16.2 is met. These assets do not have a carrying amount recorded in accordance with Australian Accounting Standards because they were expensed as incurred. Consequently, paragraph 17.6 applies to these assets: requiring them to be recognised and initially measured at their fair value.<br>Staff note that this might not have been intended, as the recognition of such assets and initial measurement at fair value does not appear to align with the Board's decisions to (1) require entity combinations to be |

| Stakeholder comments | Staff analysis |
|---|---|
| | accounted for using a book-value method; and (2) specify that an acquired donated non-financial asset for which no consideration was paid and which was recognised at its $nil cost is exempt from having to be measured at fair value as part of accounting for the entity combination. Staff further note that the donated asset requirements in paragraph 17.7 were made to align the entity combination accounting requirements with the Board's proposals regarding donated assets.<br><br>Hence, for consistency, **staff recommend** that a Tier 3 Standard should similarly also require internally generated intangible assets acquired in an entity combination to remain unrecognised. This relieves the reporting entity/ subsidiary from having to identify whether any such assets were acquired as part of the entity combination, and also from having to fair value these intangible assets. Resultantly, internally generated intangible assets such as customer lists or websites would only be recognised where acquired from another entity in a transaction that is not an entity combination.<br><br>If the Board disagrees with the staff recommendation, staff recommend that to avoid divergence in practice, the Basis for Conclusions should be extended to clarify that previously internally generated intangible assets should be recognised as part of the entity combination. |
| ***Recognition of the difference in equity*** | |
| 7. A stakeholder (other) was uncertain about the proposal not to recognise any goodwill/gain on acquisition and instead recognise directly in equity any difference between the consideration paid and net assets recognised. In their experience, there does not appear to be difficulties in recognition of goodwill for business combinations except for some diversity of treatment where the net credit may be recorded (i.e. equity, or profit or loss). | As noted in Basis for Conclusions paragraph BC99 of ED 335, the Board had heard that mergers and amalgamations are generally the most common form of entity combinations undertaken by smaller NFP private sector entities, and that goodwill is often not recognised by these entities. As such, the Board decided to propose that the differences between the consideration paid and the net assets recognised in the combination be recognised directly in equity to balance the cost to preparers with the information usefulness to users.<br><br>That is, the reason for the Board's view was not that recognising goodwill is mechanically difficult, but to minimise the ongoing costs for entities (e.g. of maintaining any goodwill balance/records, and assessing it for impairment). Staff also note that the difference recognised in equity may not wholly reflect 'goodwill' as its determination has regard to the carrying amounts of the acquired assets and liabilities, rather than their fair values.<br><br>Having regard to the above, and noting the majority support received for the proposal, **staff recommend** making no change to the proposed requirements in response to the stakeholder comment. |

| Stakeholder comments | Staff analysis |
|---|---|
| 8. Two stakeholders (professional bodies) suggested that the Board require the difference arising from entity combinations to be recognised in a specific reserve, to distinguish it from other reserves, and develop subsequent measurement and other accounting requirements in respect of the reserve.<br><br>Similar comments were made by two stakeholders as part of the outreach meetings. However, a preparer opposed the idea of mandating a specific label for this reserve account, advocating voluntary classification to facilitate easier compliance. | Staff note that developing specific requirements for the accounting of the difference between the consideration paid and the carrying amounts of the assets, liabilities and items of equity acquired beyond the initial recognition directly in equity could provide users of the Standard with more direction, and hence improve the user-friendliness of the Standard.<br><br>However, staff think that in practice Tier 3 preparers are likely to ordinarily sequester these amounts separate from other components of equity, and neither seek to recycle these amounts to the profit or loss nor transfer them to another component of equity (for example, on disposal of an acquired entity). Therefore, staff think it is not necessary to explicitly specify requirements in this regard within the Standard, adding to its length, as practice is unlikely to significantly diverge. Staff also think that the absence of a specific Tier 3 direction that the amounts cannot be recycled does not imply that they should be recycled at some point. Consequently, **staff recommend** making no changes to the Standard in response to the stakeholder comment. |
| ***Other*** | |
| 9. A stakeholder (professional services firm) proposed that the Standard should allow the recording of assets and liabilities at either their carrying value or fair value at the combination date. | In developing its proposals in ED 335, the Board considered whether to allow a book-value method to be applied for certain business combinations but require all other business combinations are accounted for under the acquisition method. The Board rejected this approach having regard to the stakeholder feedback calling for simpler and proportionate requirements for the accounting of business combinations and feedback from its NFP Project Advisory Panel that the approach in AASB 3 *Business Combinations* might be too complex.<br><br>Having regard to the input received in developing its proposals, and noting that most stakeholders supported the proposal to require a book value method to account for an entity combination, **staff recommend** making no changes to the Standard in response to the stakeholder comment. |
| 10. A stakeholder (professional services firm) observed that the requirement for uniformity of accounting policies could result in non-comparable financial statements of the acquirer where material assets experience a change in accounting | Paragraph 17.8 of ED 335 states "If any combining entities applied different accounting policies to record or measure assets or liabilities in their financial statements immediately before the entity combination, the balances of those assets or liabilities shall be adjusted as at the date of the combination to achieve uniformity of accounting policies across the combining entities". Although not obviously stated, paragraph 17.8 is applicable only in instances where paragraph 17.5 is relevant to the combination accounting. |

<table>
<tr><th>Stakeholder comments</th><th>Staff analysis</th></tr>
<tr><td>policy from the perspective of the acquirer, which is inconsistent with the Conceptual Framework For Financial Reporting.<br><br>The stakeholder noted that ED 335 as drafted does not prevent entities from entering into combinations to alter their accounting policies, which could undermine financial reporting consistency.</td><td>On reflection of paragraph 17.8, staff concur with the stakeholder concern as the text as drafted suggests that either the acquirer or acquiree's accounting policies may be adjusted to achieve the directed uniformity of accounting policies. Staff observe this is a drafting matter arising from the merger accounting origins of the proposals, and think it is inconsistent with the notion of control and parent/subsidiary relationship established in Section 8. Consequently, staff recommend that paragraph 17.8 be amended to clarify that it is the <u>acquiree's</u> accounting policies that must be adjusted before the carrying amounts of the <u>acquiree's</u> assets, liabilities and items of equity are combined with those of the acquirer/ parent.<br><br>[Staff note: In contrast to paragraph 17.8 for entity combinations, Section 13 Investments in Associates and Joint Arrangements suggests that, in applying the equity method of accounting, the uniformity in accounting policies be reflected only in the subsequent measurement of an equity-accounted investment[9]]</td></tr>
<tr><td>11. Two stakeholders (professional bodies) considered that the Standard should include:<br>• a description of "an entity", similar to how ED 335 includes describes an operating unit; and<br>• guidance on what constitutes a "major" entity combination.</td><td>"Entity" is used throughout the Standard. Staff think it is unnecessary to include a description of "an entity" similar to how ED 335 describes an operating unit as it should be clear that it is referring to the entity preparing the financial statements. However, staff intend to review and revise the drafting of Section 17 for editorial and other minor amendments, including to provide clarity as to whether the references to "an entity" are to the entity preparing the financial statements or also to the acquiree. Similarly, staff intend to review and revise the drafting to clarify that for the purposes of applying entity combination accounting, references to "combining entities" are intended to refer to the acquired entity (and not read as "either the acquirer or acquiree") – this aligns the requirements of Section 17 with the parent/subsidiary relationships in Section 8. Staff will bring our proposed amendments in this regard to a future Board meeting for the Board's consideration as part of a draft Standard (expected November 2025).<br><br>Regarding explaining "major", staff recommend making no changes to Section 17 in direct response to the stakeholder comment (that is, not adding any further guidance to Section 17 in this regard). This is because major is used also in the following places in the proposed Standard:<br>• paragraph 3.10 of ED 335 refers to a 'major disposal of assets';<br>• paragraphs 6.10 and 6.11 of ED 335 refer to 'major classes of gross cash receipts and gross cash payments'; and<br>• paragraph 15.17 of ED 335 refers to 'major components'.</td></tr>
</table>

9 Refer paragraph 13.16 of ED 335, which states "… and subsequently is adjusted … by applying the following principles…"

| Stakeholder comments | Staff analysis |
|---|---|
| | In addition, staff expect instances in which paragraph 17.12 applies to be rare as the disclosure requirement pertains only to a post-reporting date event. Also, staff think that, in many instances, it will likely be clear whether the entity combination is a major event or material to users' understanding of the entity's financial statements. |
| 12. A stakeholder (professional services firm) considered that Basis for Conclusions paragraph BC97 of ED 335 does not clearly explain why fair value measurement is necessary for material assets and liabilities that do not have a carrying amount recognised in accordance with Australian Accounting Standards and suggested the Board include further explanation in this regard. | Staff will consider whether further explanation is necessary to better clarify the interaction between the Board's decision to depart from the approach in AASB 3 *Business Combinations* but to continue to require certain assets and liabilities to be recognised at their combination date fair values (for example, by referencing the Board's preliminary position being to require the accounting in AASB 3). Staff will bring our proposed amendments in this regard to a future Board meeting for the Board's consideration as part of a draft Standard (expected November 2025). |
| 13. Two stakeholders (professional bodies) suggested that the purpose of entity combinations undertaken by Tier 3 entities as explained in paragraph BC99 of ED 335 be included in the body of the Standard, to why the requirements differ to the Tier 2 reporting requirements. | Basis for Conclusions paragraph BC99 of ED 335 states "… However, the Board heard from stakeholder feedback that mergers and amalgamations are generally the most common combinations and goodwill is often not recognised by Tier 3 entities. As such, the Board decided to propose in this ED that any differences between the consideration paid and the net assets recognised in the combination (based primarily on pre-combination book values) are recognised directly in equity to balance the cost to preparers with the information usefulness to users".<br><br>Having regard to paragraph BC99, staff think it does not specify a requirement nor adds any useful guidance to the body of the Standard. Consequently, **staff recommend** making no changes to the body of the Standard in response to the stakeholder comment. |

15 In addition to the stakeholder comments summarised in Table 2, as part of our consideration of Section 17 viz the stakeholder feedback received, staff have identified further possible editorial or minor amendments to Section 17 that have not been raised for the Board's consideration as part of this paper.[10] Staff intend to bring these recommendations, together with the changes resulting from the Board decisions on the matters noted in Table 2, to a future Board meeting for consideration as part of the Board's review of a revised draft Tier 3 Standard (expected November 2025).

***Summary of recommendations and Question to the Board***

16 Having regard to the majority support for the proposals and staff's analysis of the stakeholder concerns raised, staff recommend that the Board finalise, subject to any redrafting necessary to improve the clarity of the requirements, the Tier 3 requirements for entity combinations as exposed in Section 17 of ED 335, except as follows:

(a) regarding the date to recognise an entity combination:

(i) to require an entity combination to be recognised from the date of gaining control of the entity/ operating unit;

(ii) to include guidance that the "date of gaining control" may, where unclear, be a selected (i.e. estimated) date as long as this date is unlikely to result in a material difference to the financial performance and position of the entity; and

(iii) to require an entity to disclose the key judgements that the entity has made about the date it gains control of another entity/ operating unit, where these judgements have a significant effect on the amounts recorded in the financial statements.

(b) to amend paragraph 17.6 to clarify that an entity is not required to determine the fair value for all assets and liabilities in order to determine whether those assets or liabilities are material to the entity;

(c) to amend paragraph 17.7 to clarify that the exemption to measuring assets at fair value applies also to any acquired unrecognised donated non-financial assets for which the acquiree had not paid any consideration in exchange;

(d) to extend the exemption in paragraph 17.7 to include donated non-financial assets for which the entity paid a nominal or other significantly discounted amount, and which were originally measured at "cost". For the purposes of entity combination accounting, the carrying amount of the donated asset should be as though the Tier 3 Standard had always applied to the asset (for example, the "cost" of a donated building is subject to depreciation);

(e) to specify that an internally generated intangible assets acquired in an entity combination is not recognised; and

(f) to amend paragraph 17.8 to clarify that it is the acquiree's accounting policies that must be adjusted before the carrying amounts of the acquiree's assets, liabilities and items of equity are combined with those of the acquirer.

---

10 In considering whether there were further possible editorial or minor amendments to Section 17, staff had regard to the issue of the third edition of the IFRS for SMEs Accounting Standard (issued in February 2025). As the development of Section 17 was not based on the *IFRS for SMEs*, this Section of the Tier 3 Standard is not directly impacted by the issue of the third edition of the *IFRS for SMEs*. However, AASB 1060 was considered in developing the proposed Section 17 disclosures, and that Standard includes disclosures equivalent to those specified by the *IFRS for SMEs*. Staff note that in the third edition of the IFRS for SMEs, further disclosures are required of contingent consideration and contingent liabilities acquired in a business combination, which may eventually also be included in AASB 1060. However, staff considered that these disclosures are not relevant to the proposed Tier 3 Standard given the proposed use of a book value method and as the Board has previously decided not to require disclosure of a description of the components of the cost of the combination.

**Question 1 for Board members**

Do Board members agree with the staff recommendation in paragraph 16 above for the Board to finalise, subject to any redrafting necessary to improve the clarity of the requirements, the Tier 3 requirements for entity combinations as exposed in ED 335, except as follows:

(a) regarding the date to recognise an entity combination:

  (i) to require an entity combination to be recognised from the date of gaining control of the entity/ operating unit;

  (ii) to include guidance that the “date of gaining control” may, where unclear, be a selected (i.e. estimated) date as long as this date is unlikely to result in a material difference to the financial performance and position of the entity; and

  (iii) to require an entity to disclose the key judgements that the entity has made about the date it gains control of another entity/ operating unit, where these judgements have a significant effect on the amounts recorded in the financial statements.

(b) to amend paragraph 17.6 to clarify that an entity is not required to determine the fair value for all assets and liabilities in order to determine whether those assets or liabilities are material to the entity;

(c) to amend paragraph 17.7 to clarify that the exemption to measuring assets at fair value applies also to any acquired unrecognised donated non-financial assets for which the acquiree had not paid any consideration in exchange;

(d) to extend the exemption in paragraph 17.7 to include donated non-financial assets for which the entity paid a nominal or other significantly discounted amount, and which were originally measured at “cost”. For the purposes of entity combination accounting, the carrying amount of the donated asset should be as though the Tier 3 Standard had always applied to the asset (for example, the “cost” of a donated building is subject to depreciation);

(e) to specify that an internally generated intangible assets acquired in an entity combination is not recognised; and

(f) to amend paragraph 17.8 to clarify that it is the acquiree’s accounting policies that must be adjusted before the carrying amounts of the acquiree’s assets, liabilities and items of equity are combined with those of the acquirer.

If not, what do Board members suggest?