Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Not-for-Profit Framework Project**	**Meeting:**	204
Topic:	**Tier 3 Exposure Draft Proposals – business combinations and goodwill**	**Agenda Item:**	3 2
		Date:	21 May 2024
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Objective of this paper

1 The objective of this paper is for the Board, in relation to the feedback received on the Discussion Paper *Development of Simplified Accounting Requirements (Tier 3 Not-for-Profit Private Sector Entities)*:

(a) **to consider** staff analysis of the feedback on the Board's preliminary views about the Tier 3 requirements for business combinations and goodwill; and

(b) **decide** on the staff recommendations of the abovementioned matters for the purpose of drafting the Tier 3 Exposure Draft (ED).

Structure of this paper

2 This paper is structured as follows:

(a) Summary of staff recommendations (paragraph 3);

(b) Background and reasons for bringing this paper to the Board (paragraphs 4 – 7);

(c) Matter to be addressed based on feedback on the DP proposals (paragraphs 8 – 10);

(d) Current requirements under Australian Accounting Standards (paragraphs 11 – 16);

(e) Summary of approaches taken by selected other jurisdictions paragraphs 17 – 24);

(f) Summary of feedback from NFP PAP members on matters in this Staff Paper (paragraph 25);

(g) Findings from academic research and other literature (paragraph 26);

(h) Staff analysis and recommendations on possible Tier 3 requirements including options for simplifications for:

(i) **Matter 1**: Tier 3 measurement requirements for business combinations including possible simplifications (paragraphs 27 – 34);

(ii) **Matter 2**: Subject to the Board's decision in Matter 1, other possible simplifications based on *IFRS for SMEs* Exposure Draft proposals (paragraphs 35– 58);

(iii) **Matter 3**: whether to develop additional guidance to address the diversity in practice on recognising bargain purchase gains (paragraphs 59 – 61); and

(i) **Appendix A**: Extract of May 2023 Agenda Paper 3.1.1, staff preliminary analysis of the feedback on the DP and suggested next steps.

Summary of staff recommendations

3 Staff recommend that the Tier 3 requirements for the purpose of drafting the ED should:

(a) require the book value method for accounting for all Tier 3 combinations with no goodwill or bargain purchase to be recognised;

(b) record the difference in consideration paid and the book value of the net assets accounted for in equity; and

(c) not to develop any guidance specifically to address the diversity in accounting for bargain purchase gains.

Background and reasons for bringing this paper to the Board

4 The Board decided at its May 2023 meeting to proceed with the development of an ED on a Tier 3 Accounting Standard with simplified recognition, measurement and disclosure requirements for smaller not-for-profit (NFP) private sector entities.

5 The Board considered the summarised feedback on the DP, and staff preliminary analysis and suggested actions for the next steps in Agenda Paper 3.1.1 of the May 2023 Board meeting. At that meeting, the Board noted the categorisation to distinguish the suggested action for the next steps presented in Agenda Paper 3.1 of the May 2023 Board meeting on the topics that staff will need to bring back for further discussions and incorporate changes to the Board's preliminary views for consideration in future meetings.[1]

6 After considering the DP feedback and further staff analysis and recommendations in Agenda Paper 3.1 at the September 2023 Board meeting, discussed further in paragraph 8, the Board decided to address business combinations and goodwill and other intangible assets in the Tier 3 Standard.[2]

7 In this paper, staff are bringing analysis of the feedback on the DP and seeking the Board's direction on the matters below according to the project timeline presented in Agenda Paper 3.1 at the August 2023 Board meeting on the Tier 3 requirements for business combinations and goodwill.

Matters to be addressed based on feedback on the DP proposals

8 When developing the DP, the Board had not developed its initial view on possible Tier 3 reporting requirements in relation to business combinations and goodwill because the Board was considering Tier 3 requirements for transactions and events and conditions expected to be common to smaller NFP private sector. Consequently, as per paragraph 4.20 in the DP, the Board preliminary decided that business combinations may be a topic to be omitted from the Tier 3 Standard and entities would be directed to apply the Tier 2 requirements. However, the stakeholder feedback presented in Agenda Paper 3.1.1 at the May 2023 Board meeting indicated:

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1 Agenda Paper 3.1 of the May 2023 Board meeting presented three main categories to distinguish the suggested action for next steps based on the feedback on the DP. The three categories were:
(1) Category A (ED drafting based on DP proposals with minor issues to be resolved);
(2) Category B (ED drafting based largely on DP proposals with some potential changes); and
(3) Category C (further analysis and direction required).

2 Refer to the minutes of the 13-14 September 2023 Board meeting.

(a) business combinations are not uncommon and there is an increasing trend for NFP entities, including smaller NFP entities, to merge or acquire other entities. In particular, those stakeholders consider the approach to AASB 3 *Business Combinations* may not be fit for purpose for smaller NFP entities and it would be more appropriate to allow entities to recognise the asset at the book value of the previous NFP entity rather than requiring the acquirer to do a purchase price allocation at fair value. In addition; they considered the extent of the disclosures should be simplified;

(b) that there is diversity in practice with respect to whether a 'bargain purchase gain' is credited to profit or loss or equity; and

(c) non-financial assets acquired at significantly less than fair value should be measured at fair value if those non-financial assets were acquired through a business combination.

9 Given the Board decided to develop Tier 3 requirements that are simple and proportionate for application by smaller NFP private sector entities and in line with the Board's 'Approach to simplification' flowchart in Appendix A of Agenda Paper 3.1 for this meeting. Therefore, in developing staff recommendations for Tier 3 requirements on accounting for business combinations and goodwill, staff considered some simplifications may be warranted particularly relating to simplification of accounting for Tier 3 business combinations and goodwill.

10 While this paper would address the initial measurement of intangible assets acquired as part of a business combination, any subsequent measurement requirements of intangible assets will be considered in Agenda Paper 3.3 at this meeting as staff consider these intangible assets other than goodwill, would apply the same requirements as any other intangible assets.

Current requirements under the Australian Accounting Standards

11 NFP private sector entities are required to comply with AASB 3 *Business Combinations* to determine whether a transaction or other event is a business combination by determining if the assets acquired constitute a business. If the acquisition of an asset or a group of assets does not constitute a business, then entities are required to recognise the individual identifiable asset acquired.

Initial and subsequent measurement

12 At a high level, when a transaction or event is determined to be identified as a business combination, then an entity accounts for each business combination by applying the acquisition method as per paragraph 5 of AASB 3 consisting of:

(a) Identifying the acquirer which requires:

(i) for each business combination, one of the combining entities shall be identified as the acquirer using the guidance in AASB 10 *Consolidated Financial Statements*, that is, the entity that obtains control of another entity is the acquirer. Appendix B in AASB 3 also provides additional factors in determining whether an acquirer cannot be clearly identified based on AASB 10.

(b) Determining the acquisition date requires:

(i) the acquirer to identify the acquisition, which is the date on which it obtains control of the acquiree. The acquisition date is generally the date which the acquirer legally transfers the consideration, acquires the assets and assumes the liabilities of the acquiree – the closing date.

(c) Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlled interest in the acquiree as at the acquisition date. The acquirer is required to:

(i) recognise, separately from goodwill, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. To recognise the identifiable

assets acquired and liabilities assumed, certain conditions must be met including but not limited to meeting the definitions of assets and liabilities in the conceptual framework;

(ii) classify or designate the identifiable assets acquired and liabilities assumed as necessary to apply other Australian Accounting Standards subsequently; and

(iii) measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair value. Non-controlling interests are measured at either fair value or the acquiree's proportionate share in the recognised amounts of the acquiree's identifiable net asset; and

(d) Recognising and measuring goodwill or a gain from a bargain purchase which is determined as the excess of the consideration transferred and non-controlling interest in the acquiree, over the fair value of the net identifiable assets. If the fair value of net identifiable assets exceeds the consideration transferred and non-controlling interest in the acquiree, the resultant gain from a bargain purchase is recognised in the statement of profit or loss.

13 An acquirer subsequently measures or accounts for assets acquired, liabilities assumed or incurred and equity instruments issued in a business combination generally in accordance with other applicable Australian Accounting Standards for those items. For example, goodwill is measured at the amount recognised at the acquisition date less any accumulated impairment losses in accordance with AASB 136 *Impairment of Assets.*

14 While the Board decided that in principle there is no conceptual basis for accounting for business combinations among NFP entities differently from other, analogous, types of business combinations (per BC3 of AASB 3), however, the Board noted for local governments or universities are commonly controlled and the accounting of business combinations may differ in that regard. As such, pending further work on control in the public sector' project, the Board decided to incorporate relief carried forward from the superseded AAS 27 *Financial Reporting by Local Government* including but not limited to the following:

(a) Where assets and liabilities are transferred to a local government from another local government for no or nominal consideration due to legislative change or ministerial direction, the transferee local government shall recognise assets and liabilities at the amounts at which the transferor local government recognised the assets at transfer date or at their fair value, and any gain or loss (Aus63.1 – Aus 63.2 of AASB 3);

(b) A restructuring of local governments may take the form of a new local government as a result of State government's policy and the transferred asset will usually be recognised by the transferee at their carrying amounts in the books of the transferor at the time of the transfers. However, the recognition of transferred assets at fair value is permitted. The restructure does not involve transfers between government and its ownership groups but gives rise to a gain or loss that is recognised in the statement of comprehensive income (Aus 63.4 – Aus 63 .5 of AASB 3); and

(c) Separate disclosures of these transferred assets and liabilities are required, by class, including the identification of the transferor local government and any gain or loss recognised separately in the statement of comprehensive income (Aus 63.6 – Aus 63.7 of AASB 3).

Disclosures

15 AASB 1060 *General Purpose Financial Statements – Simplified Disclosures for For-Profit and Not-for-Profit Tier 2 Entities* requires for each business combination during the period, the acquiree to disclose the following but not limited to:

(a) name and description of the combining entities or business and the date of acquisition;

(b) the percentage of voting equity instruments acquired;

(c) the cost of the combination and a description of the components of that cost (such as cash, equity instruments and debt instruments);

(d) the amounts recognised at the acquisition dates for each class of the acquiree's assets, liabilities and contingent liabilities, including goodwill;

(e) the amount of any excess recognised in profit or loss and the line item in the statement of comprehensive income in which the excess is recognised;

(f) a qualitative description of the factors that make up the goodwill recognised; and

(g) the non-controlling interest in the acquiree recognised at the acquisition date and measurement basis for that amount for business combinations where the acquirer holds less than 100 per cent of the equity interest.

For all business combinations, an acquiree shall disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period (but prior period reconciliation is not required), showing separately:

(a) changes arising from new business combinations;

(b) impairment losses;

(c) disposals of previously acquired business; and

(d) other changes.

16 Appendix B in AASB 3 provides application guidance on identifying a business combination, definition and elements of a business, identifying the acquirer, recognising and measuring the fair value of particular assets and liabilities assumed, non-controlling interest in an acquiree and goodwill or bargain purchase.

Summary of approaches taken by other selected jurisdictions

17 The *Third edition of the IFRS for SMEs Accounting Standard* Exposure Draft issued in September 2022 proposed aligning the business combinations and goodwill requirements with IFRS 3 for *Business Combinations*. Prior to the ED proposals, the main differences between IFRS 3 and IFRS for SMEs included:

(a) applying a purchase method of accounting for a business combination which was based on IFRS 3 (2004) *Business Combinations*. The purchase method requires identifying an acquirer, measuring the cost of the business combination and allocating the cost of the business combination to the assets acquired and liabilities and provisions for contingent liabilities assumed at the acquisition date;

(b) goodwill and other indefinite-lived intangible assets are amortised over its useful life and if the useful life cannot be reliably established, then management is required to estimate the useful life but it cannot exceed 10 years (refer to paragraph BC 247 of the 2015 amendment to the IFRS for SMEs). The asset must also be assessed for impairment using the impairment indicators in the IFRS for SMEs Standard; and

(c) capitalising acquisition cost.

18 The IFRS for SMEs ED proposed alignment with IFRS 3 to apply the acquisition method of accounting with simplification that contingent consideration is required to be measured at fair value without undue cost or effort, except:

(a) the guidance on reacquired rights is proposed not be included in the IFRS for SMEs ED;

(b) non-controlling interests is measured at the acquiree's proportionate share in the recognised amounts of the acquiree's identifiable net asset rather than introducing the fair value option;

(c) retaining recognition criteria for intangible assets acquired in a business combination balances and costs and benefits of separate recognition of these items because goodwill recognised in a business combination is amortised; and

(d) acquisition-related costs are required to be expensed rather than capitalised.

The IFRS for SMEs ED also proposed to retain the requirement that goodwill and other indefinite-lived intangible assets are amortised over its useful life. The International Non-Profit Accounting Guidance (IPAG) ED 2 proposed aligning with the IFRS for SMEs ED except only for editorial changes.

19 The UK FRS 102 and UK FRS 105, Singapore Charity Accounting Standards (CAS) and Hong Kong SME-FRF & SME-FRS and INPAG guidance is based on *IFRS for SMEs* Accounting Standard prior to the third review ED proposals to align with IFRS 3, except for the following but not limited to:

<u>UK FRS 102</u>

(a) Provisions for contingent consideration are required to be discounted;

(b) Removal of the undue cost or effort exemption to fair value measurement of intangible assets;

(c) Specific guidance is provided for public benefit entities (PBE) where entity combinations that are at nil or nominal consideration, which are in substance a gift, applies the same requirements as per other business combinations (Paragraph PBE34.77) except any excess of the fair value of the assets received over the fair value of the liabilities is recognised as gains in the income and expense statement (i.e. similar to a gain from a bargain purchase noted in paragraph 12(d) above) and if liabilities assumed is in excess over the fair value of the assets received is recognised as a loss.

(d) merger accounting is permitted for group restructures provided:

    (i) the use of the merger accounting is not prohibited by company law or other relevant legislation;

    (ii) the ultimate equity holders remain the same, and the rights of each equity holder, relative to the others, are unchanged, and

    (iii) no non-controlling interest in the net assets of the group is altered by the transfer.

(e) When the combination meets the definition and criteria of a merger, as per Section 19 of FRS 102, under merger accounting, no goodwill is recognised, and

    (i) the carrying value of the assets and liabilities of the parties to the combination are not adjusted to fair value, except for any adjustments made to achieve uniformity of accounting policies across combining entities.

    (ii) The results and cash flows of all the combining entities shall be brought into the financial statements of the newly formed entity from the beginning of the financial period in which the merger occurs.

    (iii) The comparative amounts shall be restated by including the results for all the combining entities for the previous accounting period and their statement of financial position for the previous reporting date;

    (iv) The differences, if any, between nominal value of the shares issued plus the fair value of any other consideration given, and the nominal value of the shares received in exchange shall be shown as a movement on other reserves in the consolidated financial statements.

    (v) All cost associated with the merger shall be charged as an expense in the period incurred.

(vi) For disclosures, each entity combination accounted for as a merger in the reporting period shall disclosed in the newly formed entity's financial statements including but not limited to, the names and descriptions of the combining entities or businesses, the date of the merger and an analysis of the principal components of the current year's total comprehensive income to indicate the amounts relating to the newly formed merged entity.

UK FRS 105

(f) Micro-entities applying FRS 105 are required to apply FRS 102 requirements to account for business combinations except for the following but not limited to:

(i) Separate identification and recognition of intangible assets, deferred tax asset or liability acquired in a business combination is not permitted;

(ii) Share-based payment transaction and any liability (or assets if any) related to the acquired business's employee benefits arrangements would be recognised and measured in accordance with the relevant requirements in FRS 105; and

(iii) No requirement to provide any of the disclosures in FRS 102. The only disclosures required is in relation to financial commitments, guarantees and contingencies not recognised in the statement of financial position for trade and asset acquisitions.

The *Accounting and Reporting by Charities: Statement of Recommended Practice applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland* (Charities SORP) provides guidance on merger accounting requirements similar to those provided in FRS 102. However, the Charities SORP prohibits merger accounting for charities that are companies that enter into a business combination with a third party (paragraph 27.4A).

Singapore CAS

(a) goodwill is not required to be assessed for impairment and only required to be amortised; and

(b) it does not contain guidance for adjustments to the cost of a business combination contingent on future events, references to deferred tax assets/liabilities, treatment of contingent liabilities and no requirements to disclose a qualitative description of the factors that make up the goodwill recognised.

HK SME-FRF & SME-FRS

(a) acquisition-related costs are expensed rather than capitalised;

(b) a rebuttable presumption that the useful life of goodwill will not exceed 5 years from initial recognition. If presumption is rebutted, then disclosure is required on the reasons why the useful life exceed 5 years; and

(c) less disclosures compared to IFRS for SMEs ED such as for contingent consideration arrangements, no disclosure is required for a description of the arrangements and the basis for determining the amount of the payment, and no requirement to disclose the amount of any gain recognised as bargain purchases or qualitative description of the factors that make up the goodwill.

20 The Canadian ASNPO provides guidance for combinations involving two or more NFP entities. Where an NFP entity acquires a for-profit entity, the NFP entity is required to apply the for-profit requirements to account for business combinations applicable for for-profit entities that are in line with IFRS 3. Where the combination is an acquisition, the entity applies the acquisition method similar to IFRS 3. While the accounting requirements for combinations of two or more NFP entities

will depend on whether the combination is a merger or an acquisition. A combination qualifies to apply merger accounting if it meets five criteria, that is:

(a) No party is characterised as the acquirer or acquiree;

(b) Those charged with governance of the predecessor organisations participate in determining the terms of the combination;

(c) Except for transaction costs, no significant consideration flows to a third party of the organisations combining to form the reporting entity. A merger generally is accomplished by combining all the assets and liabilities of the combining entities into a single reporting entity without a transfer of cash or other assets to a third party of the reporting entity;

(d) When entities combine, the reporting entity must encompass the purposes of each of the NFP entity subject to the combination at the combination date; and

(e) No significant decline or planned significant decline in the client communities served at the combination date.

Where the combination is a merger, paragraph 4449.07 in Section 4449 *Combinations by not-for-profit organizations* requires merger accounting to apply, similar to those requirements presented in paragraph 19(e).

New Zealand Tier 3 Standard

21 The New Zealand Tier 3 Standard does not contain guidance in relation to business combinations. Where there is no guidance provided, paragraph 8 of the New Zealand Tier 3 Standard requires the entity to use judgement to determine an appropriate method of accounting by firstly considering how the Standard deals with similar or related transactions or events, then the relevant requirements in the Tier 2 PBE Standards, and the definitions and concepts in the PBE Conceptual Framework. The relevant Tier 2 NFP PBE Standard for PBE combinations is the *Public Benefit Entity International Public Sector Accounting Standard 40 PBE Combinations* (IPSAS 40). PBE entities are required to classify PBE combinations as amalgamations or acquisitions. If no party to a PBE combination gains control of one or more operations as a result of the combination, the combination is classified as an amalgamation. However, if one party gains control of one or more operations, then the entity shall consider the PBE combination's economic substance to determine whether the combination is an amalgamation.

IPSAS 40 provides guidance about when the economic substance of the PBE combination is an amalgamation based on indicators relating to consideration and the decision making process. For example, these indicators include if no consideration was paid to compensate those with an entitlement to the net assets of a transferred operation or the PBE combination is imposed by a third party without any party to the combination being involved in the decision-making process. Where a combination is:

(a) classified as an amalgamation, the entity would apply the modified pooling of interest method of accounting. The modified pooling of interests method results in a single combined resulting entity. A single uniform set of accounting policies, consistent with the requirements of PBE Standards, is adopted by that entity, and the carrying amounts of the assets and liabilities of the combining operations are adjusted, where required, to conform to those accounting policies; and

(b) classified as an acquisition, the entity would apply the acquisition method which is similar to AASB 3.

US 958 NFP Entities

22 The US Codification 958-805 provides the accounting requirements for NFP entities accounting for business combinations. Similar to the Canada ASNPO, the US requirements require NFP entities to

determine whether the combination is that of a merger or an acquisition. Combinations that is a merger apply merger accounting, similar to those presented in 19(e). For combinations that are an acquisition, then an entity applies the acquisition method of accounting. However, there is specific guidance unique to an NFP that is provided. Specifically, there are exceptions to the recognition principle provided in paragraph 805-20-25-1 relating to:

(a) the donor relationships – an NFP acquirer shall not recognise an acquired donor relationship as an identifiable intangible asset separate from goodwill;

(b) collections – an NFP acquirer that does not have a policy of capitalising collections (i.e. artwork, historical treasures or similar assets) is not permitted to recognise acquired collections as assets. Rather the entity either decreases the appropriate class of net assets by the cost of the collection items purchased or not recognise the fair value of collection items contributed either as an asset or revenue. For acquirers that recognises collections, the acquired item is added to the acquirer’s assets.

(c) conditional promises to give – an acquirer recognise a conditional promise only if the conditions on which it depends are substantially met as of the acquisition date. Alternatively, an acquirer recognises a transfer of assets with a conditional promise to contribute them as a refundable advance unless the conditions have been substantially met as at acquisition date.

Business combinations under common control

23 The IASB previously undertook a research project and issued a Discussion Paper DP/2020/2 *Business Combinations under Common Control* in November 2020 dealing with business combinations under common control which accounts for combinations in which all of the combining companies or businesses are ultimately controlled by the same party, both before and after the combination. DP/2020/2 was developed in response to stakeholder feedback that the lack of a specifically applicable IFRS Standard for such combinations has resulted in diversity in practice. At a high level, the IASB proposed a method to account for business combinations under common control by specifying a book-value method in IFRS Standards.[3] The IASB’s preliminary view on the book-value method was that:

(a) The receiving company should measure the assets and liabilities received using the transferred company’s book values;

(b) Considerations paid in assets should be measured at the receiving company’s book value of those assets at the combination date and consideration paid by incurring or assuming liabilities at the amount determined on initial recognition of the liability at the combination date by applying IFRS Standard. No prescribed requirements on how the receiving company should measure the consideration paid in own shares;

(c) Apply a book value method for privately held companies if non-controlling shareholders do not object to using the book value method for a combination;

(d) Any difference between the consideration paid and the book value of the assets and liabilities received is recognised in equity and no prescribed method in which component of equity the receiving company should present that difference;

(e) The receiving company should recognise transaction costs as an expense in the period in which they are incurred, except that the costs of issuing shares or debt instruments should be accounted for in accordance with the applicable IFRS Standards

3 Various labels are used for book-value methods applied in practice, including the predecessor method, the pooling (or uniting) of interests method and merger accounting. The IASB’s Discussion Paper uses the term ‘book-value method’ as a collective term for all these methods.

(f) The receiving company should include in its financial statements the assets, liabilities, income and expenses of the transferred company prospectively from the combination date, without restating pre-combination information; and

(g) Some, but not all, of the disclosure requirements in IFRS 3 including any improvements to those requirements resulting from the Discussion Paper *Business Combinations – Disclosures, Goodwill and Impairment*, are appropriate. No disclosures are required of pre-combination information. The receiving company should disclose the amount recognised in equity for any difference between the consideration paid and the book value of the assets received, and the component/s of equity that includes the difference.

24 In November 2023 the IASB decided to discontinue the project after considering the feedback collected on DP/2020/2.[4]

Summary of feedback from NFP PAP members on matters in this Staff Paper

25 The NFP Project Advisory Panel (NFP PAP) provided further feedback at the May 2024 meeting and one member provided feedback outside of the meeting. Members had the following views:

(a) Some members noted that goodwill is often not recognised by NFP entities because combinations in the NFP sector generally relate to an NFP entity amalgamating the assets and liabilities for nil/nominal consideration, which often does not give rise to goodwill. They also noted that:

(i) it is unclear how goodwill would be assessed in the NFP space since it may not be clear how future economic benefit could be generated from that asset;

(ii) even if goodwill is recognised, one member (auditor) noted that goodwill could be impaired on day one since these combinations mostly involve the NFP acquirer taking over a business that is not viable and, therefore, it is usually not justifiable how future economic benefits would be generated from the acquiree's goodwill.

(b) Some members preferred allowing Tier 3 combinations to be accounted for using the book value method because it recognises that smaller entities have difficulties obtaining fair value for assets acquired and liabilities assumed in business combinations. However, a few members noted concerns about all assets being measured at book value and suggested that property, plant and equipment (PPE) should be measured at fair value instead. They consider measuring PPE at fair value would be more reflective of the value of these acquired PPE (which can have overinflated book value due to unrecognised deprecation or impairment). They noted that obtaining fair value generally is not difficult especially since evidence is often available to support the fair value of PPE. They noted that some other jurisdictional requirements that require entities to consolidate from the earliest comparative period rather than from the transaction date would be complex since it may require an entity to consolidate the acquiree's assets/liabilities assumed before the acquirer gains control of the acquiree.

(c) Some members preferred to allow the book value method to account for certain combinations such as when NFP entities amalgamate for nil or nominal consideration as this is the most common combination for NFP entities especially in the National Disability Insurance Scheme, while requiring the acquisition method for other business combinations. They considered requiring smaller NFP entities to apply the acquisition method in AASB 3 would be complex.

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4 Refer to the IASB Update in November 2023. Agenda Paper 23C presented at the IASB September 2023 IASB meeting noted that the project is not a priority for most users, the deficiency in reporting may not have significant consequences and may incur significant resources to continue with the project.

(d) A member did not express a preferred approach to accounting for combinations but noted that most assets acquired, and liabilities assumed to be easy to obtain fair value as the assets and liabilities of these smaller entities generally consist of debtors, creditors, or loans, and PPE and investments are supported by evidence; hence, valuation is easily accessible.

(e) All members supported further simplifications to the acquisition method similar to those provided in the IFRS for SMEs ED noted in paragraph 18.

(f) All members did not object to the simplification of not developing guidance on the impairment of goodwill and cash-generating units in the Tier 3 ED. As noted in paragraph 25(a)(ii), one member indicated goodwill is generally impaired on day one.

(g) Members agreed that the existing guidance is clear on how to account for bargain purchase gains. However, a few members noted that there may be diversity with one member considering it to be attributed to the entity's poor accounting. They noted that under a special purpose regime where standalone accounts are being prepared, entities that come together where the acquirer controls the other entity may prepare standalone accounts later than the acquisition date. The entity may attribute the acquisition of the controlled entity as a transaction with owners to account for these transactions through equity instead of through profit or loss. Two members provided feedback outside of the meeting and also clarified that diversity mainly relates to merger accounting for mutuals or member-based Tier 1/Tier 2 NFP entities where the difference between net assets acquired at fair value and considerations resulted in net assets. There may be diversity in practice whether difference should be captured through profit or loss, or equity instead where, depending on facts and circumstances, if the membership was transferred or the new organisation is continuing the same objectives and mission, then the difference is treated as equity instead of gain in profit or loss.

Findings from academic research and other literature

26 Subramaniam, N., Lowe, A., West, R. and Venkateswwaralu, Y.N., 2018. *Mergers, amalgamations and acquisitions in the Australian not-for-profit human services sector*. *CPA Australia* conducted research into mergers and acquisitions (M&A) by interviewing 21 personnel from the NFP sector with lived experience of mergers. The findings from the research indicated that:

(a) of the 21 personnel interviewed, 11 participants were from organisations that merged, six participants were from organisations that were considered merging or embarked to merge but did not proceed;

(b) entities that enter into M&A are generally larger in size and there are primary and secondary benefits identified from M&A such as scale efficiencies improved financial positions, wider revenue base, increase in market size and provision of wider range of services to name a few.

(c) M&A restructure is an important pathway and viable means for NFP service providers in Australia to gain market share and scale efficiencies.

(d) M&A process itself is often complex, time-consuming and can be costly.

(e) motivations for NFP M&A include government funding/policy changes, financial threats, gaining scale of efficiencies and increasing market size.

Staff noted that the findings from the research indicated that M&A does occur in the NFP sector but generally by larger NFP entities. However, the findings did not indicate which type of combination (i.e. whether merger or acquisition) was more prominent in the NFP sector.

Options for simplification

27 The Board decided at its May 2023 meeting to develop an ED on a Tier 3 Accounting Standard that will contain simplified accounting requirements for smaller NFP private sector entities. Based on the

feedback on the DP noted in paragraph 8 above, staff consider there are three matters to be considered for developing the Tier 3 requirements for business combinations and goodwill:

(a) **Matter 1:** Tier 3 measurement requirements to account for business combinations including possible simplifications (paragraphs 28 – 34);

(b) **Matter 2**: Subject to the Board's decision in Matter 1, other possible simplifications based on the *IFRS for SMEs* Accounting Standard requirements (paragraphs 35– 58); and

(c) **Matter 3**: whether to develop additional guidance to address the diversity in practice on recognising bargain purchase gains (paragraphs 59 – 61).

Matter 1: Tier 3 measurement requirements for business combinations including possible simplifications

28 With reference to the 'Approach to simplification' flowchart in Appendix A of Agenda Paper 3.1 for this meeting, staff analysis considers current practice in Australia and international jurisdictions, feedback received from the NFP PAP and the academic and other literature findings. Staff consider there are 3 options on the Tier 3 measurement requirements to account for business combinations and analysis on each option in Table 1 as follows:

(a) **Option 1**: align with Tier 2 requirements for business combinations except for simplifying the language.

(b) **Option 2**: simplify the measurement requirements to apply a book-value method similar to those outlined in paragraph 19(e) and 23(a) – 23(g) whereby:

(i) the accounting for the assets and liabilities of the parties to the combination are measured at book value for all combinations. That is, this option would apply to all combinations, unlike other jurisdictions which specify certain conditions or boundaries when merger accounting can be applied. Assets and liabilities of the combination are not adjusted to fair value, except for any adjustments made to achieve uniformity of accounting policies across combining entities. The accounting would not require identification of an acquirer or acquiree;

(ii) only assets and liabilities already recognised before the combination would be recognised;

(iii) no goodwill is recognised as a result of the combination. The difference between the consideration paid and net assets acquired recognised at book value is accounted as a separate reserve in equity indefinitely. An alternative would be to require the differences to be recognised in the combined profit or loss or combined other comprehensive income;

(iv) non-controlling interest is measured at a proportionate share of the book values of the related assets and liabilities;

(v) all transaction costs relating to the combination are written off immediately and the effects of all transactions between the combining operations are eliminated in preparing the financial statements of the resulting entity;

(vi) the results and cash flows of all the combining entities shall be brought into the financial statements of either the newly formed entity, or included in the entity that exists after the combination, from the beginning of the financial period in which the merger occurs;

(vii) if a new entity is formed after the combination, no comparative information should be presented on the face of the financial statements for the periods prior to the combination date. The newly formed entity is permitted to disclose comparative information in the notes for the combined operations for the periods prior to the combination. However, if one of the entities exists after the combination, that entity

shall present comparative information, with respect to the continuing entity only, for the period prior to the combination date on the face of the financial statements with no restatement of information. The remaining entity is permitted to disclose in the notes comparative financial information for the combined operations for the periods prior to the combination.[5]

(viii) subsequent to the combination, if an entity that would have been identified as the acquirer elects to present separate financial statements rather than consolidated financial statements, then the investment in the acquired entity would be measured at book value.

(c) **Option 3**: allow a book-value method to be applied for certain business combinations and all other business combinations are accounted for under the acquisition method. Based on FRS 102, UK Charity SORP, Canada ASNPO and US 958 NFP, the combinations that would apply merger accounting could be:

(i) the combination only consists of two or more NFP entities. Where a NFP entity acquires a for-profit entity, the acquisition method of accounting must be applied;

(ii) no party in the combination is characterised as either the acquirer or acquiree;

(iii) no significant consideration flows to a third party of the combined entities that is forming the new reporting entity;

(iv) consideration for the combination are either at nil or nominal consideration; and

(v) the combined reporting entity encompasses the purpose of each NFP entity subject to the combination.

29 The Tier 3 disclosure requirements for Options 1 – 3 would be subject to the Board's decision on the approach for the accounting of business combinations in Matter 1 and will be based on the approach to developing disclosure requirements presented in Appendix B in Agenda Paper 3.1 at this meeting. That is, the disclosure requirements for:

(a) Option 1 would be based on AASB 1060 with further consideration for simplifications considered in Matter 2;

(b) Option 2 would be based on other similar jurisdictions that allow for merger accounting to be applied, including considering the disclosure requirements from the IASB's DP/2020/2; and

(c) Option 3 would be based on similar requirements from other jurisdictions that allow both merger accounting and acquisition accounting to apply for NFP combinations.

The Board will consider the Tier 3 disclosures when staff bring the next iteration of the working draft of the Tier 3 ED in a future Board meeting.

30 Staff consider there are other possible alternative approaches but did not consider them further including:

(a) apply the purchase method applied by the IFRS for SMEs Accounting Standards before its ED proposals to align with IFRS 3 acquisition method, because:

(i) as outlined in BC130 – BC143 Basis for Conclusions for the *Third edition of the IFRS for SMEs Accounting Standard,* the revised IFRS 3 was developed to address known deficiencies in IFRS 3 (2004) requirements and reduce application problems. The

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5 These requirements are based on PBE IPSAS 40 paragraphs 50-51 regarding the presentation of comparative information for either a resulting entity (where a new entity is formed after an amalgamation) or a continuing reporting entity.

guidance provided on the definition of a business in IFRS 3 was developed to address the application problems and provide clarity and understandability to users of financial statements and consistency and improve the comparability between entities' financial statements; and

(ii) the purchase method still requires the assets acquired and liabilities assumed to be measured at fair value. Hence, it may not address the feedback from stakeholders, which would make it complex for smaller entities to measure the assets acquired and liabilities assumed at fair value.

(b) the 'fresh start' method which assumes that none of the combining entities survives the business combination as an independent reporting entity. The business combination is viewed as a transfer of the net asset of the combining entities to a new entity that assumes control over them. However, as noted in BC5 of AASB 3, the AASB Board noted the potential significant costs and practical difficulties that a fresh start alternative would still impose, and, therefore, concluded that the potential advantages of using the fresh start method for some business combinations among NFP entities would be outweighed by the disadvantages. While it may resolve the need to identify an acquirer or acquiree, it may not necessarily remove the need to measure assets and liabilities at fair value.[6]

6 The IASB's materials discussing business combination under common control presented at the IASB September 2017 meeting references that 'fresh start' approach refers to measuring all assets and liabilities of all combining entities at fair values.

Table 1 Options for simplifying Tier 3 accounting for Business Combinations

Option 1 – Align with Tier 2 requirements except for the simplifying the language (other further simplifications are discussed in Matter 2 further below) *Based on AASB 3 and AASB 1060*	**Option 2 – only apply merger accounting with book-value method for all combinations** *No jurisdiction adopted book-value method for all business combinations*	**Option 3 – allow an option to apply merger accounting for certain business combinations and require the acquisition for other transactions.** *Similar to FRS 102, Canada ASNFO, US 958 NFP Entities and NZ Tier 2 requirements*
Arguments for this approach		
1) As the Research Report 19 findings did not identify many charities had acquired/merged with other entities, there may not be a need to develop any simplifications on accounting for business combinations other than simplifying the language. 2) Maintains consistency with Tier 1 and Tier 2 requirements. 3) It may be argued that business combinations are complex and should warrant accounting as close as practicable to Tier 2. 4) Applying the Tier 2 requirements enhances the relevance, reliability and comparability of information provided about business combinations and their effects. As detailed in the Basis for Conclusions of the IFRS for SMEs Accounting Standard, the IASB developed the acquisition method to address known deficiencies in IFRS 3 (2004) requirements and to reduce application problems. The IASB also decided to align the definition of business with IFRS 3 in the IFRS for SMEs ED to enhance the consistency of application and provide clarity and understandability for users of SMEs' financial statements (refer to paragraph BC130 – BC143). 5) Requiring fair value of assets acquired and liabilities assumed provides users with	1) This option addresses the concern from stakeholders regarding the complexity of applying fair value measurement in business combinations and allows Tier 3 entities to recognise assets and liabilities assumed based on the book value of the entity rather than at fair value. 2) Applying merger accounting ('book value' method) would be in line with the Board's decisions allowing Tier 3 entities a choice not to prepare consolidated financial statements and the need to assess control under AASB 10 which would be required under AASB 3 which requires the identification of an acquirer in accordance with AASB 10. 3) In paragraphs 2.41 and 2.42 of the Business Combinations under Common Control DP, the IASB considered the benefits of applying the acquisition method may not outweigh cost for privately held companies if non-controlling shareholders do not have a significant ownership interest in the company and may not rely on the company's financial statements to meet their information needs or do not routinely rely on analysis of detailed financial information. In addition, in BC163 of the IFRS for SMEs ED, the IASB did not provide an option to measure non-controlling interest at fair value, noting that the cost of measuring non-controlling interest at fair value may outweigh the benefit for SMEs. 4) Applying book value method accounting would align with the Board's decision to allow non-financial assets acquired at significantly less than fair value to be accounted for either at	1) Similar to Option 2, Option 3 addresses the concern from stakeholders to allow Tier 3 entities to apply merger accounting at least for some NFP combinations that meet certain conditions in paragraph 28(c), not to require the fair value of assets and liabilities to be determined, except for any adjustments made to achieve uniformity of accounting policies across combining entities. 2) Similar to Option 2, Option 3 could cater to the Board's decision to allow the choice for a Tier 3 entity to prepare consolidated or separate financial statements by not requiring either party of the combination to assess control under AASB 10 to identify the acquiree and acquiree in certain business combination. 3) Allows consistency with Tier 1/Tier 2 requirements for all other business combinations that are required to apply the acquisition method of accounting.

Option 1 – Align with Tier 2 requirements except for the simplifying the language (other further simplifications are discussed in Matter 2 further below) *Based on AASB 3 and AASB 1060*	**Option 2 – only apply merger accounting with book-value method for all combinations** *No jurisdiction adopted book-value method for all business combinations*	**Option 3 – allow an option to apply merger accounting for certain business combinations and require the acquisition for other transactions.** *Similar to FRS 102, Canada ASNFO, US 958 NFP Entities and NZ Tier 2 requirements*
information of the net assets and the acquired NFP entity's invested capacity to deliver services and with information to assess whether the consideration paid by the acquiring entity was reasonable. As noted by a few NPF PAP members, they consider obtaining the fair value of PPEs would not be difficult. The assets and liabilities of smaller NFP entities would generally consist of loans, debtors or creditors and PPEs which are supported by evidence, hence valuation is easily accessible. Option 1 would also enhance the usefulness of the information in financial statements since donated assets would be measured at fair value.	cost or at fair value,[7] since the book value is being applied (which is at cost). However, an entity would still have the ability to revalue PPE and consider the impairment of non-financial assets hence these assets may not be carried at cost indefinitely. 5) As noted in paragraph 25, NFP PAP members noted that goodwill is often not recognised in the NFP space. As such, Option 2 aligns with the current practice of not recognising goodwill.	
Arguments against this approach		
1) This option may not provide sufficient simplifications to address the feedback from stakeholders that the approach in AASB 3 to apply to smaller NFP entities is complex. 2) As noted in the summary of approaches taken by other jurisdictions, many other jurisdictions provided some form of simplification or alternative method of accounting for business combinations in the NFP sector. 3) This option may not cater to the Board's decision to allow Tier 3 entities not to assess control, given under the acquisition method, an entity is	1) Reduce comparability between NFP entities complying with Tier 1 or Tier 2 requirements. 2) The arguments supporting Option 1 to align the requirements with Tier 2 are arguments against Option 2. 3) Not recording goodwill omits recognising the price paid for any synergies expected from the combination. The difference between the acquirer's cost of investment and the acquiree's equity presented as a separate reserve in equity indefinitely. However, as noted in BC111 of the 2nd comprehensive review of the IFRS for SMEs Accounting Standard, feedback indicated that users of SMEs financial statements find little, if any, information content in goodwill at all, for example, lenders	1) Developing the book value method and the acquisition method accounting in accordance with AASB 3 would lengthen the Tier 3 Standard and may be considered to be more difficult for preparers to determine which method should be applied to account for business combinations. 2) The arguments against applying the acquisition method in Option 1 would apply in Option 3.

7 Refer to the minutes of the 7-8 March 2024 AASB Board meeting.

Option 1 – Align with Tier 2 requirements except for the simplifying the language (other further simplifications are discussed in Matter 2 further below) *Based on AASB 3 and AASB 1060*	Option 2 – only apply merger accounting with book-value method for all combinations *No jurisdiction adopted book-value method for all business combinations*	Option 3 – allow an option to apply merger accounting for certain business combinations and require the acquisition for other transactions. *Similar to FRS 102, Canada ASNFO, US 958 NFP Entities and NZ Tier 2 requirements*
required to identify the acquirer based on control under AASB 10. 4) The measurement of goodwill applying the acquisition method is based on the premise that the amount of the consideration paid to acquire the business is determined in an arm's length negotiation and depends on the fair value of the acquired business and the price for any synergies expected from the combination (BC316 of IFRS 3) In the NFP sector, entities may combined/acquire/merge with other entities at nil or nominal consideration as confirmed by NFP PAP members. As such, the acquisition method might measure goodwill at an arbitrary amount that does not provide useful information. However, as noted in BC3 of AASB 3, the Board noted that the difficulties associated with business combinations that do not involve consideration are also issues that may be encountered in business combinations for for-profit entities (such as combinations by contract alone). Therefore, consistent with transaction-neutral principles, the board did not consider that there was sufficient reason to justify a different accounting treatment for business combinations among NFP entities. NFP PAP members noted that even if goodwill was recognised, it would be impaired on day one since it is not clear how	generally do not lend against goodwill as an asset. However, as the NFP PAP members noted, goodwill is often not recognised in the NFP sector. 4) Applying the book value method may not give a true representation of the exchange in value in a business combination compared to requiring fair values of the assets acquired and liabilities assumed or incurred, as noted in paragraph 25 by some NFP PAP members noting at least for PPEs should be measured at fair value. In addition, the Tier 3 DP feedback called out that assets acquired at significantly less than fair value acquired in a business combination should be measured at fair value. Given the Board's decision to at its March 2024 Board meeting to allow an accounting policy choice for donated assets to be initially measured at cost of at fair value,[8] then donated assets that are initially measured at cost, that is, nil in value, would not be recognised in the business combination under the book value method since only assets and liabilities that are already recognised before the combination would be recognised. While the Board could specifically require donated assets to be measured acquired in a business combination, however, a similar argument could be applied for other assets carried at cost should also be measured at fair value since applying the book value means depreciated assets would be measured at their residual carrying amount only. 5) As noted in paragraph BC27 of IFRS 3, the IASB concluded that most combinations, both two-party transactions and those involving three or more entities, are acquisitions. Even though	3) The arguments against applying the book value method in Option 2 would apply in Option 3. 4) As noted in IFRS3.BC27 and BC 35, it may be argued that most business combinations are acquisitions and 'true mergers' or 'mergers of equals' are so rare as to be virtually non-existent. As such, the need to apply merger accounting may be rare; therefore, a separate accounting treatment is not warranted. The IASB also noted when developing IFRS 3 that their constituents and respondents were unable to suggest an unambiguous and non-arbitrary boundary for distinguishing true mergers or mergers of equal from other business combinations and concluded that developing such an operational boundary would not be feasible.

8 Refer to minutes of the March 2024 Board meeting.

Option 1 – Align with Tier 2 requirements except for the simplifying the language (other further simplifications are discussed in Matter 2 further below) *Based on AASB 3 and AASB 1060*	**Option 2 – only apply merger accounting with book-value method for all combinations** *No jurisdiction adopted book-value method for all business combinations*	**Option 3 – allow an option to apply merger accounting for certain business combinations and require the acquisition for other transactions.** *Similar to FRS 102, Canada ASNFO, US 958 NFP Entities and NZ Tier 2 requirements*
future economic benefit could be generated from that asset. 5) Requiring assets acquired and liabilities assumed to be measured at fair value can be costly especially for smaller NFP entities. However, staff do not expect the cost would be ongoing since business combinations would not occur frequently. This would then support referring 3 entities to AASB 3, similarly for complex financial instruments to be referred to AASB 9. 6) The Board had made several proposals not to require fair value measurement, for example allowing an accounting policy to initially measure non-financial assets acquired at significantly less than fair value at cost or fair value or concessional loans to be measured at transaction price rather than a fair value (refer to March 2024 meeting minutes). As such, Option 1 requires an acquirer to measure an acquiree's assets and liabilities assumed at fair value may not align with those Board proposals.	some multi-party combinations might not be acquisitions, the acquisition method has generally been used to account for them. While acknowledging that identifying an acquirer is difficult and that applying the pooling method would provide better information in those circumstances, the IASB concluded that it would be practicable to identify an acquirer in all business combinations. 6) Information may be less relevant because it has less predictive value and is less complete as it does not reflect assets acquired or liabilities assumed that were not included in the pre-combination financial statements of the combining entities. 7) All selected other jurisdictions require the acquisition method, even if not applied to all combinations. Hence, if the book value method was developed to account for all combinations for Tier 3 entities, it may reduce the 'level playing field' for Australian NFP entities to that of similar-sized NFP entities reporting to other jurisdictions.	

Evaluation of options against the Tier 3 Principles

31 In addition to the analysis in Table 1 above, staff also analysed each of the proposed options against the Tier 3 principles presented in the 'Approach to simplification' flowchart in Appendix A of Agenda Paper 3.1 at this meeting. Staff consider each set of the proposed options is broadly aligned with the Tier 3 principles, but note the following:

Table 2 Evaluation of options against the Tier 3 Principles

Principles	Staff assessment
Accounting requirements do not impose disproportionate costs on preparers when compared to the benefits of the information	Option 1 and Option 3 would impose the greatest cost to preparers compared to Option 2 given feedback on the DP indicated that AASB 3 is complex to apply for smaller NFP entities. Staff consider the Board's decision not to require Tier 3 entities to assess control for consolidation purposes, would apply similarly not to require Tier 3 entities to apply AASB 3 which may impose disproportionate cost to preparers when compared to the benefits of the information to require the acquisition method to fair valuing assets acquired and liabilities assumed in the business combinations. Option 3 may impose even greater costs to preparers as the entity would need to apply judgement to determine which method (i.e., acquisition method or merger accounting) should be applied to account for business combinations.
Consistency with the accounting principles specified by Tier 2: Australian Accounting Standards – Simplified Disclosure is describable but might not always be warranted since Tier 3 requirements are being developed as a proportionate response	Options 1 and Option 3 to require or allow the acquisition method to continue to be applied is consistent with Tier 2 requirements. However, staff consider that some disclosures required in other jurisdictions such as the reason for the combination, the consideration paid for may provide sufficient information for users of Tier 3 financial statements regarding the rationale and amount paid for the combination.
Where possible, leveraging the information management uses to make decisions about the entity's operations	Option 2 may, in staff view, to a large extent leverage the information management uses by allowing the entity to apply the book-value method for business combinations without the need to obtain the fair value of the assets acquired and liabilities assumed which may require technical expertise/valuer to obtain such information.

Staff recommendation

32 Staff recommend Option 2 based on the arguments presented in Table 1. That is, simplifying the measurement requirements to require the book value method for all combinations given Option 2 would address the concern from stakeholders that obtaining the fair value for assets identified and liabilities assumed may be difficult, especially for smaller entities. It will also simplify the requirements for entities not having to consider goodwill accounting requirements and not require entities to identify an acquirer or acquiree of a business combination which aligns with the Board's decision not to require Tier 3 entities to identify control entities.

33 Some PAP members indicated support for Option 2 except to require PPE to be measured at fair value because entities may not have assessed impairment appropriately, therefore PPE may be over/undervalued. However, staff do not recommend such exceptions to the application of the book value method because:

(a) staff do not consider the reason to require only PPE to be measured at fair value would be so unique from requiring any other assets or liabilities to also be measured at fair value; and

(b) selecting some items to be measured at fair value may incidentally create goodwill.

34 Staff note that the term 'merger accounting' is used in other jurisdictions only when the combination meets certain conditions. Given that the staff recommended Option 2 would apply to all Tier 3 NFP combinations, staff may consider other terms to be applied to draft the requirements, such as 'combinations applying the book value method' to distinguish it from merger accounting.

Question 1: Do Board members agree with the staff recommendation in paragraph 32, for the purpose of drafting the Tier 3 ED:

(a) to require the book value method for accounting for all Tier 3 combinations with no goodwill or bargain purchase to be recognised; and

(b) difference in any consideration paid and the book value of the net assets are accounted for in equity?

If not, what does the Board suggest?

35 Only if the Board **disagrees** with the staff recommendation and prefers either Option 1 or Option 3 in Matter 1 to require the acquisition method of accounting for Tier 3 entities for all or some business combinations, then staff think the Board should consider whether the simplifications contained in the IFRS for SMEs Accounting Standard ED noted in paragraph 18 to simplify the acquisition method should also be provided in the Tier 3 requirements. These simplifications are discussed in Matter 2 below.

Matter 2: Other possible simplifications based on the *IFRS for SMEs* Accounting Standards ED

36 As noted in paragraphs 17 – 18, while the IFRS For SMEs ED proposes to align the guidance on business combinations and goodwill with IFRS 3, the IASB also propose some simplifications to the acquisition method of accounting. Except for expensing acquisition-related costs which is required already in AASB 3, staff consider the simplifications to the acquisition method proposed in IFRS for SMEs ED should also be provided in the Tier 3 requirements, that is:

(a) not to include the guidance on reacquired rights;

(b) an acquirer does not recognise a contingent liability assumed in a business combination that is not a liability;

(c) not to provide an option to measure non-controlling interest at fair value; and

(d) amortising goodwill.

Not to include the guidance on reacquired rights

37 As per paragraph B35 of AASB 3, as part of a business combination, an acquirer may reacquire a right that it has previously granted to the acquiree to use one or more of the acquirer's recognised or unrecognised assets. Examples of such rights include a right to use the acquirer's trade name under a franchise agreement or a right to use the acquirer's technology under a technology licensing agreement. A reacquired right is an identifiable intangible asset that the acquirer recognises separately from goodwill. Paragraph 29 of AASB provides guidance on measuring a reacquired right and paragraph 55 provides guidance on the subsequent accounting for a reacquired right.

38 Staff note that the IASB proposed not to include guidance on reacquired rights into the *IFRS for SMEs* Accounting Standard because they considered reacquired rights not common for SMEs (refer to BC158).

39 As such, staff consider not including guidance on reacquired rights for Tier 3 entities on the same basis that staff do not expect it will be common for Tier 3 entities to occur and that including guidance on such rights may introduce complexities for Tier 3 entities if the guidance is not simplified. As such, staff recommend that Tier 3 requirements not include any guidance on reacquired rights.

Question 2: Do Board members agree with the staff recommendation in paragraph 39 not to include any guidance on reacquired rights for the purpose of drafting the Tier 3 ED?

If not, what does the Board suggest?

An acquirer does not recognise a contingent liability assumed in a business combination that is not a liability

40 IFRS 3 (AASB 3) requires entities to recognise contingent liabilities only if they are present obligations arising from past events whose fair value can be measured reliably. To simply the recognition of contingent liabilities, the IFRS for SMEs ED proposed to clarify that an acquirer does not recognise a contingent liability assumed in a business combination that is not a liability. Instead, an SME would recognise contingent liabilities assumed in a business combination only if it is a present obligation and would prohibit an SME from recognising 'possible obligations'.

41 As per BC165, "*the IASB noted that this clarification:*

(a) *Would improve the financial information provided;*

(b) *Would remove the efforts needed to measure the 'possible obligations' at fair value (removing the unnecessary complexity from the Standard); and*

(c) *Would result in the recognition of an amount of goodwill that more faithfully represents the underlying economics of the business combination (avoiding any potential overstatement of the amount of goodwill recognised)."*

42 Staff recommend allowing a Tier 3 acquirer not to recognise a contingent liability assumed in a business combination that is not a liability based on the reasons in paragraph 41.

Question 3: Do Board members agree with the staff recommendation in paragraph 42 allowing a Tier 3 acquirer not to recognise a contingent liability assumed in a business combination that is not a liability for the purpose of drafting the Tier 3 ED?

If not, what does the Board suggest?

Not to provide an option to measure non-controlling interest at fair value

43 IFRS 3 (AASB 3) permits the acquirer to measure any non-controlling interest in the acquiree at fair value or the non-controlling interest's proportionate share in the recognised amounts of the acquiree's identified net asset. In the IFRS for SMEs ED, the IASB proposes not to include the option of measuring non-controlling interests at fair value. As noted in BC160 – BC164 of the IFRS for SMEs ED, the IASB was of the view that introducing such an option would add complexity to the IFRS for SMEs Accounting Standard, particularly when the acquiree's shares are not traded in an active market.

44 There were differing views amongst IASB members, where the IASB observed that measuring non-controlling interest at the proportionate share of the acquiree's identified net assets recognises only the parent's share of the goodwill. The IASB also noted that the option to measure non-controlling interest at fair value would align with IFRS 3, be more consistent with the way other components of a business combination are measured, and be useful in decision-making. However, as per BC 163, the *IASB noted that:*

(a) *This treatment is optional in IFRS 3 and effectively represents an exception to the measurement principle in IFRS 3;*

(b) *Not introducing the option is a simplification and the cost of measuring non-controlling interest at fair value may outweigh the benefit for SMEs; and*

(c) *The measurement principle in Section 19 requires recognition in full of the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values (except for retaining the simplified criteria for recognising intangible assets acquired in a business combination and that principle is consistent with the reporting entity perspective."*

45 Staff recommend that similar to the rationale in paragraphs 43 – 44, not to include an option to measure non-controlling interest at fair value as a simplification for Tier 3 entities.

Question 4: Do Board members agree with the staff recommendation in paragraph 45 not to include an option to measure non-controlling interest at fair value for the purpose of drafting the Tier 3 ED?

If not, what does the Board suggest?

Requirement on impairment and amortisation of goodwill

46 Only if the Board disagrees with the staff recommendation in Matter 1 in paragraph 32 and prefer Options 1 or 3 (i.e. to retain the acquisition method to account for business combinations), then another form of Tier 3 simplification that staff suggest is not to require impairment of goodwill (discussed in paragraphs 47 – 52, and allow similar simplifications for amortisation of goodwill (discussed in paragraphs 53 – 58), similar to the requirement of the *IFRS for SMEs* Accounting Standard.

<u>*Impairment of goodwill*</u>

47 While the Board decided to include guidance on value in use in the Tier 3 ED, the Board had not decided whether to exclude the guidance on cash-generating unit (CGU) as recommended by staff at its March 2024 Board meeting as the Board indicated they would need to consider the proposals for Tier 3 requirements for business combinations.[9]

48 In line with Agenda Paper 4.7 at the March 2024 Board meeting, staff recommended excluding the guidance on CGU and also the requirement for impairment of goodwill from the Tier 3 ED as a form of simplification. Instead, staff suggested the requirement of the *IFRS for SMEs* Accounting Standard to require amortisation of goodwill over a period not exceeding ten years to be replicated in the Tier 3 ED (discussed from paragraph 53 onwards) as a mechanism of writing down the carrying amount of goodwill without the need to determine the value in use of goodwill as part of one or more CGU.

49 This is because, per the arguments presented in Agenda Paper 4.3 at the March 2024 meeting, including the requirements for impairment of goodwill in the Tier 3 ED would require the recoverable amount of goodwill to be estimated using its value in use. Making such estimates would generally require a high level of accounting/valuation expertise in view of the inherent complexity of estimating value in use of goodwill as part of one or more CGU. This would result in considerable complexity of guidance, raising questions about whether it would be proportionate for Tier 3 entities. Other arguments for not requiring Tier 3 entities to consider impairment of goodwill were:

(a) It will shorten the Tier 3 ED (i.e. it would not require guidance to be included in relation to the impairment of goodwill);

(b) It would provide simplifications and reduce judgement and the cost involved to estimate the recoverable amount of goodwill; and

(c) As noted in paragraph 25, some NFP PAP members confirmed that goodwill is often not recognised in the NFP sector and one member generally impairs goodwill on day one since it is

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9 See minutes of the March 2024 Board meeting.

difficult to justify the future economic benefits of that assets, further supporting the argument that determining the recoverable amount of goodwill is difficult for smaller NFP entities.

50 If the Board decides not to require the impairment of goodwill in the Tier 3 requirements, then the Board may also consider not including guidance relating to CGU because the recoverable amount of goodwill cannot be calculated on a stand-alone (individual asset). Not including CGU guidance will also further simplify and shorten the Tier 3 requirements.

51 However, staff note that providing guidance for value in use and CGU would align with Tier 2 requirements and with the Board's preliminary view in the DP (refer to paragraph 5.160(c) – 5.160(d)). Additionally, including CGU guidance would allow impairment to be considered for a group of assets where they do not generate independent cash flows rather than on an individual asset basis.

52 Staff recommendation remains to not require the impairment of goodwill and not to include guidance on CGU based on the arguments in paragraph 48 – 50.

Question 5: Do Board members agree with the staff recommendation in paragraph 52 for the purpose of drafting the Tier 3 ED:

(a) not to require impairment of goodwill; and

(b) not to include guidance on CGUs?

If not, what do the Board suggest?

Amortisation of goodwill

53 Staff is aware that in the *IFRS for SMEs* Accounting Standard 2nd comprehensive review, the IASB acknowledged that users of financial statements may not find useful the information content in the amortisation of goodwill over an arbitrary period of years (i.e. not exceed 10 years) when developing IFRS 3 and related amendments to IAS 38 *Intangible Assets* (see paragraph BC109 IFRS for SMEs 2nd Comprehensive review).

54 However, from the feedback from the IFRS for SMEs 2nd comprehensive review, stakeholders indicated strong support for permitting amortisation of goodwill and that SMEs should not be required to distinguish between intangible assets with finite and indefinite useful lives. The IASB acknowledged that allocating an arbitrarily determined maximum period for amortising goodwill with a maximum period would not faithfully represent economic benefits. However, the IASB decided for cost-benefit reasons, rather than conceptual reasons that goodwill and other indefinite-lived intangible asset should be considered to have finite lives and amortised over their estimated useful lives, with a maximum amortisation period of ten years (refer to BC108 – BC112 of IFRS for SMEs ED).

55 In its IFRS for SMEs ED, the IASB continue to not propose changes to amend the requirements to change the recognition criteria for an intangible asset acquired in a business combination that are not recognised separately are amortised through the annual amortisation of goodwill (refer to BC145 of IFRS for SMEs ED). As such, staff recommend that, for the purpose of drafting the Tier 3 ED, to include similar requirement to amortise goodwill in a business combination over their estimated useful lives, with a maximum amortisation period of ten years.

56 If the Board agrees with staff recommendation in paragraph 52 not to require impairment of goodwill, the consequences could be an overstatement of goodwill on the balance sheet if an entity's circumstances change, such as structural changes that may warrant the review of the estimated useful life of goodwill. In that regard, staff suggest including guidance on trigger events/indicators when an entity would need to assess the useful lives of goodwill similar to those the Board decided

for Tier 3 impairment indicators[10] such as when management or entity structural changes, to trigger reviewing the useful lives.

57 If management considers the estimated useful lives have changed, staff suggest applying a prospective approach for changes in accounting estimates as noted in Agenda Paper 5.3 at the November 2023 Board meeting.[11]

58 Staff have also identified an alternative approach to amortise (akin to a write-off) the entirety of goodwill in the first year, similar to an NFP PAP member's comments on some instances of current practice to impair goodwill on day one noted in paragraph 25. As per BC112 of the IFRS for SMEs Accounting Standard 2nd comprehensive review indicated that in the context of SMEs, users of financial statements may not consider information content in goodwill, e.g. lenders generally do not lend against goodwill as an asset. Therefore, staff consider that, by analogy, the usefulness of information may not be reduced even if goodwill was immediately written off, and the accounting requirement would be simple to apply. However, staff consider it would not faithfully represent the economic reality of goodwill and not the most conceptually correct approach. As such, staff have not considered the alternative approach further.

Question 6: Do Board members agree with the staff recommendation in paragraphs 55 – 56, for the purpose of drafting the Tier 3 ED, to require goodwill:

(a) **to be amortised over their estimated lives with a maximum amortisation period of ten years; and**

(b) **to assess for changes to its useful lives based on 'trigger event' such as when management or structural changes, with changes in estimated useful lives to be accounted for by applying a prospective approach.**

If not, what does the Board suggest?

Matter 3: whether to develop additional guidance to address the diversity in practice on recognising bargain purchase gains

59 As noted in paragraph 8(b), stakeholder feedback on the DP indicated that there is diversity in practice with respect to whether a 'bargain purchase gain' is credited to profit or loss or equity. As stated in paragraphs 34 of AASB 3, an acquirer will make a bargain purchase if the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed exceeds the aggregate of the consideration transferred, the amount of any non-controlling interest in the acquiree and the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree for a business combination achieved in stages.

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10 The Board decided at its April 2022 Board meeting that non-financial assets other than inventory, is only required to be assess for impairment when they have physically damaged or when their service potential might have affected adversely by a change in the entity's strategy or changes in external demand for the entity's services.

11 Agenda Paper 3.1 for the May 2023 Board meeting presented three main categories to distinguish the suggested action for next steps based on the feedback from the Discussion Paper. The three categories were: (1) Category A (ED drafting based on DP proposals with minor issues to be resolved); (2) Category B (ED drafting based largely on DP proposals with some potential changes); and (3) Category C (further analysis and direction required).Changes in accounting estimates was classified as Category A, meaning most stakeholders agreed with the Board's preliminary views in the DP, and consequently, staff recommend drafting the the Tier 3 ED section based on the preliminary views in the DP

60 Paragraph 34 of AASB 3 further states that the acquirer recognises the resulting gain in profit or loss on the acquisition date where the gain shall be attributed to the acquirer. A bargain purchase might happen in a business combination that is a forced sale in which the seller is acting under compulsion.

61 While staff note the feedback on the DP about the diversity in accounting for bargain purchase gains, staff do not recommend any specific Tier 3 guidance should be developed to deal with the diversity in practice because bargain purchase gain is not unique to Tier 3 and would be also and mostly relevant to Tier 1 and Tier 2 entities, and the Board considered not making any changes to the existing Tier 1 and Tier 2 requirements as part of this project. Staff are also unclear why there is diversity given paragraph 34 in AASB 3 requires the bargain purchase gain recognised in profit or loss as confirmed by NFP PAP members noted in paragraph 25. However, as clarified by some NFP PAP members, it appears that some practitioners are referring to AASB 3 considerations for mutual entities when arriving to crediting the bargain purchase directly to equity, as well as considering requirements of AASB 1004 and AASB 1058.

Question 7: Do Board members agree with the staff recommendation in paragraph 61 not to develop any guidance specifically to address the diversity in accounting for bargain purchase gains, for the purpose of drafting the Tier 3 ED?

If not, what does the Board suggest?

Appendix A – Extract of the summary of detailed feedback presented in Agenda Paper 3.1.1 at the May 2023 Board meeting

<table>
<tr><th colspan="2">Q11) Items proposed to be excluded from the Tier 3 accounting requirements*</th></tr>
<tr><td>297 (76%) did not disagree with the items proposed to be excluded from the Tier 3 requirements including 1 written submission (UWA)</td><td>Most stakeholders agree with the proposed items to be excluded from the Tier 3 accounting requirements and consider the items proposed would not be common to smaller NFP entities (including UWA). One stakeholder suggests to develop guidance for the proposed items when they become more common.</td></tr>
<tr><td>105 (24%) disagree with the items proposed in particular the following items:
• Biological and agricultural assets = 7 (of which 1 from written response (BDO))
• Insurance contracts = 8
• Expenditure incurred in relation to exploration for and evaluation of mineral resources = 4
• Business combinations = 30 (of which 8 from written responses (PP, MA, CPA/CA ANZ, SD KPMG, DH, ACNC, BDO))
• obligations under defined benefit superannuation plan = 13
• share-based payment arrangements = 7
• service concession arrangement = 9 (of which 1 from written response (BDO))
• complex financial instruments = 15 (of which 1 from written response (DH))</td><td>Some stakeholders disagree with the proposed items. For those that disagree:
• most of the stakeholders requested guidance for business combinations because of the increasing trend for NFP entities, including smaller entities, to merge or acquire other entities (including PP, MA, CPA/CA ANZ, SD KPMG, DH, ACNC, BDO). In particular, the approach to AASB 3 Business Combination may not be fit for purpose for smaller NFP entities and it would be more appropriate to allow entities to recognise the assets at book value of the previous NFP rather than requiring the acquirer to do a purchase price allocation at fair value. In addition, the extent of the disclosures should also be simplified and there is diversity in practice with respect to whether a ‘bargain purchase gain’ is credited to profit or loss or equity (MA, KPMG);
• a few stakeholders consider biological assets and agricultural assets should not be scoped out from Tier 3 Standard as NFP entities may have community gardens. Smaller entities could be cultivating plants or rearing animals for communal purposes. Some assistance to NFP entities in addressing organic growth would be helpful (CPA/CA ANZ) or alternatively Tier 3 requirements could be silent and entities can apply a related Tier 3 requirement (e.g. inventory measured at costs) (BDO);
• a few stakeholders consider not to require opt up to AASB 9 for complex financial instruments given the objective of a stand-alone standard especially due to the complexity for smaller NFP entities applying AASB 9. If AASB permit opting up to AASB 9, there may be inconsistencies between Tier 3 and AASB 9 where Tier 3 does not allow hedge accounting but AASB 9 allows hedge accounting for items at amortised cost (i.e. simple financial instruments) (DH);
• a stakeholder noted the accounting by an operator in service concession arrangement should be scoped in otherwise it will force preparers to apply full AAS under Interpretation 12, including for any financial assets, intangible assets and revenue which would need to be accounted under AASB 9, AASB 138 and AASB 15 respectively. An alternative approach is for the operator in service concession arrangements not be scoped out of Tier 3. Instead, the Tier 3 Standard could be silent on these arrangements and entities can account for financial instruments, intangible assets and revenue as appropriate (BDO).
No other comments were provided for the other items identified by the stakeholders not to be omitted from the Tier 3 accounting requirements.</td></tr>
</table>

Staff analysis: Having regard to RR 19, the findings did not identify any of the proposed list of items in the sample charities financial statements, hence it would indicate that the proposed list of items to be omitted would be considered uncommon. However, staff thinks there is merit in consider some of the topics due to the stakeholder feedback including:

- business combinations – many of the respondents that disagree consider it would not be uncommon for NFP entities, including smaller entities, to merge or to acquire other entities. Therefore, staff will consider whether guidance should be developed within the Tier 3 Standard regarding business combinations and conduct analysis including possible simplification options for the Board to consider at a future Board meeting;
- biological and agricultural assets – while the topic does not appear to be common for smaller NFP entities, however based on feedback staff think there may be merit to consider whether biological assets should be:
  - scoped out explicitly from the Tier 3 Standard; or
  - be silent in the Tier 3 Standard, which allows a Tier 3 entity to apply a related Tier 3 requirement instead.

  Further discussion on the accounting for biological assets, if not explicitly scoped out from a Tier 3 Standard, is provided in question 31;
- Complex financial instruments – the Board has previously considered the approach to financial instruments and considered for Tier 3 to provide simplified accounting requirements for basic or common financial instruments only. This approach aligns with the objective of developing simplified accounting requirements for common transactions only. In addition, the Board considered where an entity engaging in transactions or other events giving rise to holdings of complex financial instruments should be able to apply the more complex accounting specified by the existing AASB 9 *Financial Instruments*. Where Tier 3 does not explicitly highlight or address a particular financial instrument or transaction, an entity can apply a related Tier 3 requirement instead. However, staff will need to conduct further analysis and determine possible options to assess whether there is merit in developing accounting requirements for all financial instruments rather than only for common/basic financial instruments(refer to Q21) to address complexity highlighted by the hedge accounting example. Staff will bring analysis of possible options at a future Board meeting; and
- Service concession arrangements – only a few stakeholders suggested this topic should not be scoped out and staff preliminary view is that the topic is not a common transaction for smaller NFP private sector entities. However, staff will consider possible options which may include: 1) developing simplified requirements on the accounting for service concession arrangements; 2) simplifying the requirements by language only; 3) being silent on the requirements rather than scoping out explicitly from the Tier 3 Standard; or 4) continue to scope out the topic from the Tier 3 Standard.

For the other topics proposed (insurance contracts, expenditure incurred in relation to exploration for and evaluation of mineral resources, obligations under defined benefit superannuation plan and share based payments arrangements, as there were no comments received from those respondents that disagreed, staff propose the Board to proceed with drafting the Tier 3 requirements to explicitly omit these items from the Tier 3 Standard.

Staff suggested action for next steps: Staff will need to perform **further analysis** for topics including business combination, biological and agricultural assets, complex financial instruments and service concession arrangements for the Board to consider at a future meeting. Staff recommend to **proceed with the Board's preliminary view** excluding insurance contracts, expenditure incurred in exploration for and evaluation of mineral resources, obligations under defined benefit superannuation plan and share-based payments arrangements from a Tier 3 Standard.