

Urgent Issues Group

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Acquisitions and Goodwill – First-Time Application of Accounting Standards

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URGENT ISSUES GROUP

ABSTRACT 34

**ACQUISITIONS AND GOODWILL –
FIRST-TIME APPLICATION OF ACCOUNTING STANDARDS**

ISSUE

1. Accounting standards in Australia may be applied for the first time by a foreign company re-domiciled in Australia or by an Australian entity which has become a reporting entity. Transitional provisions in AASB and AAS Accounting Standards apply where the Accounting Standard is first applied.
2. This Abstract deals only with the interaction between Accounting Standards AASB 1015 and AAS 21 “Acquisitions of Assets” (as issued in November 1999) and Accounting Standards AASB 1013 and AAS 18 “Accounting for Goodwill” (as issued in June 1996), when an entity first applies AASB or AAS Accounting Standards. The interaction between these Standards can be difficult to interpret in respect of a previous purchase/acquisition transaction, whether accounted for under pooling (or uniting) of interests accounting or the purchase method of accounting. (In the remainder of this Abstract, references to AASB 1015 and AAS 21 “Acquisitions of Assets” refer to the November 1999 version of these Standards. Similarly, references to AASB 1013 and AAS 18 “Accounting for Goodwill” refer to the June 1996 versions of these Standards. References to Australian accounting standards encompass both the AASB and AAS series of Accounting Standards.)
3. The issues are:
 - (a) whether an entity that previously applied pooling of interests accounting, or a method of purchase accounting other than that specified by AASB 1015 and AAS 21, can continue to apply that method to past acquisitions when the entity is first required to prepare financial reports in accordance with Australian accounting standards; and
 - (b) whether AASB 1013 and AAS 18 permit a different amount of goodwill determined on a first-time application of AASB 1015 or AAS 21 to be recognised in place of the carrying amount of goodwill (if any) recognised before the application of the Standards.

CONSENSUS

4. **A reporting entity applying Australian accounting standards for the first time must apply the purchase method of accounting to all acquisitions of entities or operations, where practicable, except for reconstructions within an economic entity as referred to in Accounting Standard AAS 21 “Acquisitions of Assets” (November 1999).**
5. **Where the purchase method of accounting is first applied under Australian accounting standards to the acquisition of an entity or an operation:**
 - (a) **the amount of goodwill or discount on the acquisition must be measured, where practicable, in accordance with the requirements of Accounting Standards AASB 1015 and AAS 21 “Acquisitions of Assets” (November 1999);**
 - (b) **the goodwill or discount on acquisition, measured in accordance with paragraph 5(a), must be accounted for in accordance with the requirements of Accounting Standards AASB 1013 and AAS 18 “Accounting for Goodwill” (June 1996); and**
 - (c) **any adjustments to the carrying amount of goodwill or discount since acquisition which would otherwise be recognised in net profit or loss/result must be made against retained profits (surplus) or accumulated losses (deficiencies) as at the beginning of the reporting period to which the Standards are first applied.**

Application and Operative Date

6. **This Consensus applies to reporting entities when Accounting Standard AASB 1015 or AAS 21 “Acquisitions of Assets” (November 1999) is first applied.**

DISCUSSION

7. Australian accounting standards deal specifically with the first-time application of those standards by a reporting entity through transitional provisions which specify the method of accounting required in the reporting period to which a Standard is first applied.
8. Accounting Standards AASB 1015 and AAS 21 “Acquisitions of Assets” explain in paragraph 5.1.1 that under the purchase method

of accounting acquired assets are measured at their cost of acquisition. The Standards require an acquirer to be identified for all acquisitions of entities or operations and specify that the purchase method of accounting must be applied to those acquisitions. The Standards also require that on their initial application:

- (a) where practicable, the accounting policies required by the Standard must be applied as at the beginning of the reporting period to which the Standard is first applied;
 - (b) the net amount of any initial adjustments which would otherwise be recognised in net profit or loss/result must be adjusted against retained profits (surplus) or accumulated losses (deficiencies) as at the beginning of the reporting period to which the Standard is first applied. However, the Standards also provide that where it is not practicable to determine these initial adjustments, the amounts at which the assets acquired (and, where applicable, liabilities assumed) were initially recognised are deemed to have been determined in accordance with the requirements of the Standard; and
 - (c) where a reconstruction within an economic entity occurred prior to the beginning of the reporting period to which the Standard is first applied, the accounting for that acquisition must not subsequently be adjusted.
9. The transitional provisions in AASB 1013 and AAS 18 “Accounting for Goodwill” specify that when the Standard is first applied, any goodwill or credit balance relating to the acquisition of an entity, or part thereof, which was included in the financial statements is deemed to have been determined in accordance with the Standard. Therefore, there is the potential for an incompatibility to arise in respect of the application of the transitional requirements of AASB 1015 and AAS 21 and of AASB 1013 and AAS 18 on the first-time application of AASB or AAS Accounting Standards.
10. The Consensus resolves any potential incompatibility by clarifying that the Australian accounting standards dealing with acquisitions and goodwill are applied for the first time in the following manner:
- (a) first, the requirements of Accounting Standards AASB 1015 and AAS 21, which require the purchase method of accounting for acquisitions, are applied to prior acquisitions, where practicable. A consequence of this is that an entity which has previously applied the pooling of

interests method of accounting, or a method of purchase accounting other than that required by AASB 1015 and AAS 21, to an acquisition must where practicable change to the purchase method of accounting required by AASB 1015 and AAS 21;

- (b) secondly, the transitional provisions of AASB 1015 and AAS 21 are applied as at the beginning of the reporting period to which the Standard is first applied, with the net amount of any initial adjustments which would otherwise be recognised in net profit or loss/result being adjusted against opening balances of retained profits (surplus) or accumulated losses (deficiencies). (However, where it is not practicable to determine these adjustments, the amounts at which the assets and liabilities acquired were initially recognised are deemed to have been determined in accordance with the Standard); and
 - (c) thirdly, the requirements of Accounting Standards AASB 1013 and AAS 18 are applied in respect of goodwill or discount on acquisition recognised as a consequence of applying the purchase method of accounting in accordance with AASB 1015 and AAS 21.
11. This Consensus confirms that reporting entities that have previously adopted a pooling of interests method of accounting are required to apply the purchase method of accounting for acquisitions when applying Australian accounting standards for the first time. In applying the purchase method of accounting for the first time, adjustments are made, where practicable, to the carrying amounts of the assets and liabilities acquired so that the carrying amounts reflect the amounts that would have been determined if the entity had always applied AASB 1015 or AAS 21. Where the entity had previously applied a pooling of interests method, an amount for goodwill normally would not have been recognised. In that case, the transitional provisions of AASB 1013 and AAS 18, which deem pre-existing balances of goodwill or discount on acquisition to have been determined in accordance with the Standard, would not be relevant.
12. The Consensus also confirms that reporting entities that have previously applied a purchase method of accounting for an acquisition that does not comply with all of the requirements of AASB 1015 or AAS 21 are required to apply the purchase method specified in those Standards when applying Australian accounting standards for the first time. In these circumstances, it will be necessary to make adjustments to the carrying amount of goodwill

or discount on acquisition to comply with these Accounting Standards where practicable, despite the transitional provisions of AASB 1013 and AAS 18.

Reconstructions Within an Economic Entity

13. When reissued in November 1999, both AASB 1015 and AAS 21 allowed identifiable assets acquired (and identifiable liabilities assumed) in a reconstruction within an economic entity to be recognised at either their carrying amounts or their fair values. Related transitional provisions, in paragraph 11.3 of the Standards, provided that the accounting for such a reconstruction which had occurred prior to the beginning of the first reporting period to which the Standard was first applied was not to be adjusted. On 17 February 2000 the Senate passed a resolution disallowing paragraphs 6.3 and 6.4 of AASB 1015. As a consequence, the option to recognise assets acquired in a reconstruction at their carrying amounts is no longer available for entities which are subject to AASB 1015. However, the Senate did not disallow the related transitional provision in paragraph 11.3 of AASB 1015.
14. Application of the transitional provision in paragraph 11.3 of AASB 1015 when an entity first applies AASB Accounting Standards in general would mean that all acquisitions that took place prior to the initial application of AASB 1015 must be accounted for in accordance with the purchase accounting requirements of AASB 1015, except for those acquisitions that occurred in a reconstruction within an economic entity and were accounted for previously on some other basis. However, a prohibition on adjusting the accounting applied to a previous reconstruction within an economic entity is not consistent with the Senate's action in removing from entities subject to AASB 1015 the option to account for acquisitions that occurred in such reconstructions differently from other acquisitions. Consequently, the Consensus clarifies that this transitional provision will not apply when an entity first applies AASB Accounting Standards. It reflects the Urgent Issues Group's view that the application of this transitional provision in this circumstance is not consistent with requiring all acquisitions to be accounted for in the same manner.
15. However, the equivalent transitional provision in paragraph 11.3 of AAS 21 continues in effect, and would apply when an entity first applies AAS Accounting Standards in general. This is because AAS 21 retains the option to account for assets and liabilities transferred in a reconstruction within an economic entity at either their carrying amounts or their fair values.

Application and Operative Date

16. The operative date of AASB 1015 is half-years ending on or after 30 June 2000 and financial years ending on or after 31 December 2000. The operative date of AAS 21 is reporting periods beginning on or after 1 January 2000. However, entities may elect to apply the Standards before those dates. The Consensus applies when AASB 1015 or AAS 21 is first applied. This is when entities that are applying Australian accounting standards for the first time may experience difficulty in interpreting the relationship between the transitional provisions in AASB 1015 and AAS 21 and in AASB 1013 and AAS 18, and would consider whether it is necessary to change the accounting previously adopted for reconstructions within an economic entity.

REFERENCES

Australia

The Urgent Issues Group discussed Issue Summary 00/1 “First-Time Application of Accounting Standards – Acquisitions and Goodwill” at meetings on 23 February and 11 May 2000.

Accounting Standards AASB 1013 and AAS 18 “Accounting for Goodwill”

Accounting Standards AASB 1015 and AAS 21 “Acquisitions of Assets”

International Accounting Standards Committee

Standing Interpretations Committee Interpretation SIC-8 “First-Time Application of IASs as the Primary Basis of Accounting”