



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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Agenda Item

8

DATE: August 26, 2009
MEMO TO: Members of the IPSASB
FROM: Annette Davis
SUBJECT: Entity Combinations

OBJECTIVES OF THIS SESSION

- To **consider** responses to the May 2009 ED 41, “Entity Combinations from Exchange Transactions”;
- To **discuss** views and options as to how to address respondents’ concerns on major issues; and
- To **agree** the next steps to complete the project.

AGENDA MATERIAL

- 8.1 Respondent’s Comments Regarding Key Issues (Cut and Paste)
- 8.2 Analyses of Respondents by Geographic Location, Function and Language
- 8.3 Agenda number not used
- 8.4 Response Booklet (previously circulated)

BACKGROUND

Project History

1. At the Moscow meeting in June 2008, the Board formed a preliminary view that the entity combinations project should result in two standards:
 - (a) Entity combinations arising from exchange transactions and not under common control; and
 - (b) Entity combinations arising from non-exchange transactions under common control and not under common control.
2. Staff was directed to develop an Exposure Draft based upon IFRS 3 “Business Combinations” for component 1(a) above, i.e. entity combinations arising from exchange transactions and where the entities were not under common control. The Board considered that combinations arising from exchange transactions and under common control did not occur and thus has not been included in this project.
3. An extract of the minutes from the February 2009 meeting is in the Appendix.

4. ED 41 was approved, out of session, and was issued on May 7, 2009. The comment period expired on August 15, 2009. As at August 24, a total of 13 responses have been received. Copies of the responses can be found at **AP 8.4**.

Overall Summary

5. Four of the 13 respondents (#2, 3, 4 and 11) expressed positive support for ED 41 and the development of a Standard. Another four respondents (#6, 7, 9 and 10) expressed qualified support, in that they supported development of ED 41, but, in addition, want to see development of guidance on entity combinations from non-exchange transactions not under common control and entity combinations arising in entities under common control.
6. However, another four respondents (#1, 8, 12 and 13) considered that ED 41 should not be finalized either because entity combinations from exchange transactions are not relevant to the public sector (respondents #1, 8 and 12) or because ED 41 departs from IFRS 3, “Business Combinations” without sufficient public sector reasons for departure. Respondent #5 did not express an overall view.
7. Staff has used judgment in drawing out whether an issue raised is a key issue or a minor comment. The analysis in this memo should therefore be read in conjunction with the responses themselves.
8. The Staff consider that the key issues raised in the responses are as follows.
 - (a) Whether ED 41 is relevant to public sector entities;
 - (b) That the limitation of scope to entity combinations from exchange transactions is not supportable; and
 - (c) That a separate project should be initiated on goodwill.
9. Due to the closeness of the expiry date of the comment period to the meeting date, an analysis of the other issues that respondents have raised has not been presented. This will be completed and sent to Members subsequent to the September 2009 meeting.

ANAYSIS OF KEY ISSUES

Key Issue #1 – ED 41 not relevant to the public sector

10. Respondents #1, 8 and 12 clearly consider that entity combinations from exchange transactions is not a relevant topic for the public sector. Respondent #8 considered that where such a transaction arises, the hierarchy in IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors,” will direct a preparer to a relevant standard. Respondent #8’s concern relates to the complexity of the guidance in ED 41 putting at risk the acceptance of the entire suite of IPSASs, due to the rarity of occurrence of these types of combinations.

Similarly, respondent #1 considers that ED 41 is of only "... marginal interest as a standard applicable to the public sector" as it does not address public sector specific issues relating to entity combinations.

11. Respondent #12 considers that ED 41 "... provides no demonstrable benefits to the users of public sector financial statements..." but considers that the reason ED 41 is not relevant is because ED 41 is "... conceptually inconsistent with the purposes of government financial statements and the needs of users." Instead, development of a standard on entity combinations should be deferred until the conceptual framework project is completed.
12. All three respondents considered that emphasis should instead be given to public sector specific situations such as entity combinations from non-exchange transactions.

Analysis

13. Paragraphs AG1 and AG2 of ED 41 include two examples of situations in which ED 41 would be applied. The first example is the purchase, by a federal government, of the majority of the shares in an airline. The second example is the purchase, by a provincial government, of a hospital. Both examples are based upon actual examples that occurred in the public sector.
14. Staff undertook further work to assess whether there are other examples of entity combinations from exchange transactions. Staff found other examples, such as a national government acquiring a rail operation and a local government acquiring a farm. Staff notes that this type of entity combination may be more prevalent in some public sector jurisdictions while not occurring in other jurisdictions. For example, Respondents #6 and 9 consider that the application of ED 41 would be limited in their jurisdictions.
15. Further, it is difficult to determine what will happen in the future. A jurisdiction which currently does not envisage this type of entity combination ever occurring may have a situation in which this type of entity combination does occur. Thus, Staff considers that while entity combinations arising from exchange transactions may be somewhat rare, they do occur in practice, and therefore, guidance is required.

Key Issue #1 – Question for IPSASB:
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Do you agree that entity combinations from exchange transactions need to be addressed since, while rare, they do occur in some jurisdictions?

Key Issue #2 – Scope limitation

16. Respondents #7 and 13 consider that the proposed scope of ED 41 is inappropriately limited. Respondent #7 is concerned that the exchange/non-exchange distinction will be difficult to apply in practice because of the difficulty in distinguishing between an amount paid in an exchange transaction resulting in

- the recognition of goodwill, and an amount transferred in a non-exchange transaction. Respondent #7 recommends that the scope of ED 41 be expanded to include entity combinations from non-exchange transactions. Respondent #7 acknowledges that there may be practical issues in identifying entities or operations under common control, but considers that this issue is jurisdictional rather than being an accounting standard-setting issue.
17. Respondent #13 also considers that the scope of ED 41 should be expanded to include entity combinations from non-exchange transactions, however, their reason for recommending that the scope is expanded, is because they are not aware of a public sector reason to justify the departure from IFRS 3, “Business Combinations.”

Analysis

18. To extend the scope of ED 41 to include entity combinations from non-exchange transactions causes difficulties where entity combinations occur between different levels of public sector entities, such as between a federal government and a provincial government. The IPSASB, at its February 2009 meeting, generally agreed that whether or not an entity combination takes place between entities under common control is dependent upon the jurisdiction. The accounting treatment for an entity combination from a non-exchange transaction not under common control was also debated at the February 2009 meeting and no decision was made as to the appropriate accounting treatment. Thus, the IPSASB agreed that this issue needed to be examined in further detail before any decisions could be made. Staff considers that, at this stage, the scope of ED 41 should not be expanded until the IPSASB reaches a conclusion regarding the appropriate accounting treatment for entity combinations from non-exchange transactions.
19. The public sector specific reason for limiting the scope of ED 41 to entity combinations from exchange transactions is that public sector entities generally undertake many non-exchange transactions. This can be contrasted with private sector entities whereby, very few transactions are non-exchange in nature. This difference between the sectors has been noted as one of the reasons to depart from an underlying IFRS in the IPSASB’s “Process for Reviewing and Modifying IASB Documents.” In contrast, Respondent #2 supports the IPSASB’s approach to limit the scope of ED 41 to exchange transactions only, because IFRS 3 is not intended to address entity combinations from non-exchange transactions.
20. Further, due to the prevalence and importance of this issue, the IPSASB has a separate project underway to consider entity combinations from non-exchange transactions. Staff notes that several respondents (#3, 6, 8, 10,) encouraged the IPSASB to develop guidance on entity combinations from non-exchange transactions as quickly as possible.
21. Therefore, Staff considers that the scopes of ED 41, being limited to entity combinations from exchange transactions is appropriate at this point in time.

Key Issue #2 – Question for IPSASB:

Do you agree that it is appropriate to limit the scope of ED 41 to entity combinations from exchange transactions?

Key Issue #3 – Initiation of project on goodwill

22. Four respondents (#2, 6, 9 and 12) made suggestions regarding goodwill or purchase premium arising from the acquisition of a non-cash-generating operation. Respondents #2 and 9 propose that paragraph AG 41 relating to the accounting treatment of goodwill or purchase premium arising from the acquisition of a non-cash-generating operation should be included in the Standard paragraphs and not left to the Application Guidance as it is a significant deviation from IFRS 3. Additionally, this deviation from IFRS 3 should be explained in the Basis for Conclusions. Respondent #6 proposes that a separate project be initiated to review the accounting treatment for goodwill in public sector entities as they consider that goodwill lacks context in the not-for-profit public sector context. Respondent #12 considers that any purchase premium arising from an acquisition of a governmental unit should be changed to expenses in the period of acquisition.

Analysis

23. At its February 2009 meeting, the IPSASB discussed whether or not goodwill could arise on the acquisition of a non-cash-generating operation. It was noted that IPSAS 21, “Impairment of Non-Cash-Generating Assets” deals with testing of impairment of non-cash-generating assets. IPSAS 21 does not consider that unallocated service potential, including goodwill, will arise at a non-cash-generating unit level. The IPSASB agreed that ED 41 should include Application Guidance regarding the application of IPSAS 21 to the acquisition of non-cash-generating units. In addition, the Introduction to ED 41 will also explain the application of IPSAS 21 and IPSAS 26.
24. Staff has also received comments off line regarding the appropriateness of including guidance on this issue only in the Application Guidance. Given the level of comment on this issue, Staff considers that a separate project could be initiated on goodwill on non-cash-generating operations.

Key Issue #3 – Question for IPSASB:

Do you agree that a project should be initiated on the accounting treatment for goodwill or purchase premium arising on the acquisition of a non-cash-generating operation?

APPENDIX: EXTRACT FROM FEBRUARY 2009 MEETING MINUTES

Approve ED 41 (Agenda Item 4)

The IPSASB considered draft ED 41, "Entity Combinations from Exchange Transactions." The proposed adaptations from IFRS 3, "Business Combinations" are based on the directions the IPSASB gave the Staff at its June 2008 meeting.

The IPSASB discussed the proposed distinction between an acquisition of a business and an acquisition of a function which was introduced to enable any residual arising on an acquisition of an integrated set of activities and assets which predominantly encompass service potential to be identified and immediately expensed. Some Members commented that it would be difficult to distinguish between a business and a function. Other Members thought that the accounting treatment of any residual arising from an entity combination is a separate issue from the acquisition itself. Therefore, the distinction between business and function is not necessary. Furthermore, it was noted that the distinction is artificial and unnecessary. Any definition needs to cover a range of entity combinations rather than being characterized as either an acquisition of a business or an acquisition of a function. The IPSASB agreed that the proposed split between an acquisition of a business or function is unnecessary and should be removed.

It was suggested that the term "operation" should be used instead of the terms "business" and "function" as the word operation encompasses the range of activities that are acquired. The IPSASB agreed that the terms business and function should be replaced with one definition, based on the definition of a business, using the word "operation."

Initially, there was support for the distinction between a function and a business on the basis that it is necessary to ensure that any residual arising on an acquisition of a non-cash-generating unit is immediately expensed. Some commented that there are two impairment standards within the IPSASB suite of standards which could be amended to cover the issue of impairment testing of any residual. It was also noted that goodwill only occurs in a cash-generating environment and therefore any residual arising on the acquisition of a non-cash-generating unit should be immediately expensed. The Staff noted that IPSAS 21, "Impairment of Non-Cash-Generating Assets" deals with testing of impairment of non-cash-generating assets. IPSAS 21 does not consider that unallocated service potential, including goodwill, will arise at a non-cash-generating unit level. Hence, non-cash-generating assets are tested for impairment at the individual asset level. The IPSASB agreed that ED 41 should include proposed consequential amendments to IPSAS 26 so that guidance on how to test any goodwill arising on cash-generating units will be included. The IPSASB also agreed that Application Guidance will be included in ED 41 regarding the application of IPSAS 21 to the acquisition of non-cash generating units. The Introduction to ED 41 will also explain the application of IPSAS 21 and IPSAS 26.

It was questioned whether the split in ED 41 between exchange and non-exchange entity combinations was the best distinction to use. Specifically, can entity combinations be clearly divided between exchange and non-exchange transactions? A suggested approach could be to distinguish between entity combinations occurring between a willing

buyer/seller, i.e., where there is no compulsion and then use accounting requirements based upon IFRS 3. It was also acknowledged that the line between exchange and non-exchange transactions is sometimes unclear; however, the IPSASB discussed this split when debating the project on revenue from non-exchange transactions, which resulted in IPSAS 23. A Member commented that the suggestion regarding "no compulsion" could be used instead as an indicator, to help in distinguishing between an exchange or non-exchange transaction, but ultimately, it is not a clear distinction.

It was suggested that, instead of the split between exchange and non-exchange entity combinations, "restructures within the public sector that are imposed by, or subject to approval of, the relevant government" be scoped out of any standard based upon IFRS 3. The effect of this proposal would be to limit the scope of ED 41 to combinations where a government expands the boundaries of the government.

The IPSASB agreed that ED 41 should be consistent with existing IPSASB standards and retain the exchange/non-exchange split. However, wording in the Introduction should reflect that ED 41 is limited to convergence with IFRS 3 and that other types of entity combinations which occur in the public sector will be addressed separately in order to determine the appropriate accounting treatment.

A Member commented that it was not clear whether mergers between public sector entities are within the scope of ED 41. Another Member commented that IFRS 3 asserts that an acquirer can always be identified but, the context of IFRS 3 is that entity combinations take place by using an exchange transaction. The fact that non-exchange transactions are prevalent in the public sector is a key difference between the public sector and the private sector. Another Member supported this approach because ED 41 addresses entity combinations from exchange transactions only and thus mergers which do not meet this definition are outside the scope of ED 41. It was agreed that this point needs to be made in the Basis for Conclusions of ED 41 and draft wording was proposed. The IPSASB also agreed that the second sentence of IN6 should be removed as it asserts that the acquirer can always be identified.

Other changes to ED 41 were agreed as follows:

- Amendment of the heading above paragraph 43 (IFRS 3 ref) to refer to "indirect acquisitions" rather than "acquisitions where no consideration is transferred."
- Amendment of paragraph 43 (IFRS 3 ref) to delete sub-paragraphs (b) and (c) as these situations do not arise in the public sector.
- Deletion of paragraph 44 (IFRS 3 ref) as it is not relevant due to the amendment of paragraph 43.
- Amend definition of "ownership interests" to be consistent with IPSAS 6.

The IPSASB directed Staff to redraft ED 41 in light of these comments and to circulate it for comment and ultimate approval out of session, jointly with ED 40 (see item 3 above).

Entity Combinations from Non-Exchange Transactions

The IPSASB considered an issues paper on entity combinations from non-exchange transactions. The paper is based on the directions the IPSASB gave the Staff at its June 2008 meeting. The IPSASB considered the following key issues.

KI 1: Amendments to the definitions of an acquiree, acquirer and entity combination

The Staff proposed that for entity combinations arising from non-exchange transactions the parties to the combination are more appropriately described as "recipient" instead of "acquirer" and "transferee" instead of "acquiree," with a consequential amendment to the definition of an entity combination. These terms are consistent with the terms used in IPSAS 23. The IPSASB agreed with this proposal.

KI 2: Identifying whether entities are under common control is dependent upon the structure and legislation in a particular jurisdiction

The Preface to IPSASs sets out the types of public sector entities to which IPSASs are designed to apply, including national governments, regional governments and local governments. The Staff consider that whether lower levels of government are controlled by higher levels of government is dependent upon the structure and legislation in place in a particular jurisdiction. The IPSASB discussed this assertion. A Member commented that applying this assertion will not lead to comparability between jurisdictions. Another Member agreed with this assertion, but noted that this should not pre-empt decisions regarding the accounting treatment of these types of entity combinations.

Another Member pointed out that whether or not an entity combination takes place between entities under common control is a matter of substance over form. There needs to be differentiation between the ability of a legislature (i.e., parliament) to mandate an entity combination from the ability of the executive (i.e., ministries or departments) to mandate an entity combination. Another Member commented that whether or not a lower level of government is under the control of a higher level of government is fact based. It was also noted that control for the purposes of financial reporting is based upon power and benefits of ownership rather than regulatory control and any subsequent Consultation Paper on this issue should cover this point.

The IPSASB generally agreed that whether or not an entity combination takes place between entities under common control is dependent upon the jurisdiction. However, the accounting treatment of this type of entity combination (from a non-exchange transaction under common control), is a separate issue. The IPSASB also agreed that the issues raised need to be addressed in the next stage of this project.

KI 3: Internal restructuring within an economic entity of existing entities

The Staff set out an example where a provincial government restructures a program by transferring it from one department to another department. The Staff proposed that in the recipient entity, recognition should be of existing assets and liabilities; measurement should be at carrying amount and any difference arising should be a contribution from

owners. A Member commented that, for some situations, fresh start accounting could be appropriate.

Another Member commented that carrying amount is a sensible approach since there are no resulting consolidation adjustments in the economic entity's consolidated financial statements. From a performance measurement perspective, the recipient entity could change its measurement basis and revalue the assets it received from the entity combination transaction. It was noted that, in practice, whether to revalue assets before or after an entity combination is a much-debated issue. It was also pointed out that the onus is on the parties to an entity combination to agree on the approach taken to the valuation of assets, before the entity combination is undertaken. The IPSASB generally agreed that the accounting proposed for the recipient entity appears to be consistent with their view.

KI 4: *Internal restructuring within an economic entity by creating a new entity*

The Staff set out an example where a national government transfers the operations of two boards or commissions into a new entity. The Staff proposed that in the recipient entity, i.e., the new entity, recognition should be of existing assets and liabilities; measurement should be at carrying amount and any difference arising should be a contribution from owners. The IPSASB generally agreed that the issues that arise in this example are similar to the ones highlighted in Key Issue 3.

KI 5: *External restructuring to transfer one entity into another entity*

The Staff set out an example where a federal government creates legislation which mandates that the operations of one municipality are annexed into another municipality, in a jurisdiction where municipalities are not under the control of the federal government. At its June 2008 meeting, the IPSASB held a preliminary view that this type of entity combination should be accounted for at carrying amount. At that meeting, it was acknowledged that this treatment may be inconsistent with some of its other Standards, such as IPSAS 23, where initial measurement of an asset, received in a non-exchange transaction, is fair value.

A Member commented that the conclusion reached in IPSAS 23 was a practical solution rather than a conceptual decision as there was no other practical method to measure the asset. A difference between a non-exchange transaction and a non-exchange entity combination is that, in an entity combination, the carrying amounts are known (because there is access to the accounting records). Therefore, the IPSASB could justify a departure from the treatment in IPSAS 23. Additionally, in jurisdictions where financial statements are also used for the assessment of taxes or rates payable, recognizing assets at fair value increases the depreciation charge and thus the cost of services is seen to rise. Another Member commented that, for practical purposes, where a jurisdiction undertakes regular restructuring of its entities, that carrying amount is the simplistic solution.

Another Member commented that where a new entity is created it may be better to recognize assets and liabilities at fair value so that the entity's performance can be properly assessed. Another Member commented that, at present, it was difficult to find a

good rationale to differentiate between acquiring an asset in a non-exchange transaction from the acquisition of an operation.

Another Member pointed out that the first priority is to have consistency of accounting treatment within a particular area, in this case, entity combinations and therefore, the accounting treatment in IPSAS 23 is not relevant to the discussion of the appropriate accounting treatment of entity combinations from non-exchange transactions.

Another aspect that was highlighted is where an entity combination from an exchange transaction is under common control as this is not addressed in IFRS 3.

Overall, the IPSASB considered that a key point from this discussion is that it was a practical decision in IPSAS 23 to require assets acquired from non-exchange transactions to be measured at fair value on initial recognition. This practical decision should not limit the development of an accounting treatment for entity combinations from non-exchange transactions. The IPSASB agreed that the issues raised, as noted above, need to be examined in further detail.

RESPONDENTS’ COMMENTS ON KEY ISSUES

Purpose:

The May 2009 Exposure Draft 41, “Entity Combinations from Exchange Transactions,” did not contain any specific issues on which comment was sought.

This paper presents staff’s analysis of the key issues respondents raised to ED 41, as analyzed in AP 8.0.

List of Respondents:

Response #	Respondent Name	Response #	Respondent Name
1	Comité des Normes des Comptabilité Publique (France)	8	Swiss Public Sector Financial Reporting Advisory Committee (SRS-CSPCP)
2	Public Sector Accounting Board (Canada)	9	Accounting Standards Board (South Africa)
3	Accounting Standards Board (UK)	10	Audit Commission (UK)
4	Japanese Institute of Certified Public Accountants	11	CIPFA (UK)
5	Dr. Joseph Maresca	12	Comptroller General, British Columbia (Canada)
6	HoTARAC (Australia Heads of Treasuries Accounting and Reporting Advisory Committee)	13	Joint Accounting Bodies (Australia)
7	Australian Accounting Standards Board		

Comments by Issue

#	RESPONDENT NAME	OVERALL COMMENT – SUPPORTIVE
2	Public Sector Accounting Board (Canada)	PSAB staff support IPSASB’s approach to limit converging IFRS 3, <i>Business Combinations</i> , to entity combinations from exchange transactions in public sector because IFRS 3 is not intended to address entity combinations from non-exchange transactions.
3	Accounting Standards Board (UK)	<p>1. The UK Accounting Standards Board’s Committee on Accounting for Public Benefit Entities (CAPE) welcomes the opportunity to comment on the International Public Sector Accounting Standards Board’s (IPSASB) proposals in Exposure Draft 41 ‘<i>Entity Combinations from Exchange Transactions</i>’. CAPE supports the IPSASB’s policy to develop a set of accrual based International Public Sector Accounting Standards that are convergent with IFRSs issued by the International Accounting Standards Board, where appropriate for public sector entities.</p> <p>2. We agree with IPSASB that, in the absence of any specific public reasons for departure, ED 41 should be a converged standard, ie it should maintain the requirements, structure and text of IFRS 3 ‘<i>Business Combinations</i>’. We also agree with the changes that are proposed in deleting material from IFRS 3 that is not relevant to public sector entities.</p>
4	Japanese Institute of Certified Public Accountants	The Japanese Institute of Certified Public Accountants (JICPA) is pleased to comment on the Proposed International Public Sector Accounting Standard, “Entity Combinations from Exchange Transactions” (the “ED”), as follows: We agree with IPSASB’s proposal.
6	HoTARAC	HoTARAC supports the proposed IPSAS in that it does not differ too significantly from IFRS 3 <i>Business</i>

	(Australia Heads of Treasuries Accounting and Reporting Advisory Committee)	<i>Combinations.</i>
7	Australian Accounting Standards Board	The AASB supports the IPSASB's programme to update the convergence of accrual basis International Public Sector Accounting Standards (IPSASs) with International Financial Reporting Standards to the extent appropriate for public sector entities. Accordingly, the AASB agrees with the IPSASB's decision to use IFRS 3 <i>Business Combinations</i> as the basis for ED 41. The AASB particularly welcomes the release of a version of the ED that highlights proposed differences from IFRS 3.
9	Accounting Standards Board (South Africa)	While we support the development of an International Public Sector Accounting Standard on (IPSAS) <i>Entity Combinations from Exchange Transactions</i> , we do not envisage wide application of this IPSAS in the public sector. Our response is structured into general matters and editorial amendments.
10	Audit Commission (UK)	The Commission welcomes the approach taken by the Board that, in the absence of any specific public sector reasons for departure, ED 41 should be converged with the requirements, structure and text of IFRS 3 ' <i>Business Combinations</i> '.
11	CIPFA (UK)	We strongly support IPSASB's project to develop a suite of IFRS converged IPSASs on relevant issues, closely reflecting IFRS where this is possible, and providing interpretation or additional guidance where this is necessary.

#	RESPONDENT NAME	KI #1 ED 41 NOT RELEVANT TO THE PUBLIC SECTOR
1	Comité des Normes des Comptabilité Publique (France)	<p>We have taken note of the convergence process towards IFRS 3 undertaken by the IPSAS Board under the Exposure Draft on "Entity Combinations from Exchange Transactions" although we regret that in this project as in other current Exposure Drafts are not addressed the specificities of the public sector. We point out the IFRS have been at first designed with the objective of meeting the financial reporting purpose for profit-oriented corporation and for public distribution and therefore are not designed to deal with the specificities of the public sector.</p> <p>The Exposure Draft meets the objective of convergence but sets out only a marginal interest as a standard applicable to the public sector.</p> <ul style="list-style-type: none"> The interest of the proposed standard is weakened by the exclusion of non-exchange transactions (see § 3 and table page 4). Therefore, the technical requirements for the recognition and measurement transposed from IFRS 3 are useful only if it is possible to assess their applicability in the public sector, and that is not the case in the proposed Exposure Draft. The illustrative examples used seem ultimately irrelevant (see § AG1 to AG3). <p>Indeed, only retaining in the scope the exchange transactions, while excluding non- exchange transactions leads to further restrict the scope and the usefulness of the standard.</p>

#	RESPONDENT NAME	KI #1 ED 41 NOT RELEVANT TO THE PUBLIC SECTOR
		<p>The Exposure Draft excludes from its scope the processing of cases likely to be the most frequent case of a public entity like a public institution by which an entity combination cannot be achieved neither by a transfer of securities nor a non-exchange transaction.</p> <ul style="list-style-type: none"> • In addition, the objective of IFRS 3 is to propose methods for assessing the transaction to identify the actual cost of the combination when it occurs. Its responds to an issue of comparability between companies. The issue is not of the same nature in the public sector. • One can also question the relevance of the measurement policy using the fair value model in the non profit sector which has a significant number of public institutions. I believe that the above points should be taken into account in the Exposure Drafts to come which include within their scope the non market sector and the non exchange transactions.
8	SRS-CSPCP	<ul style="list-style-type: none"> • However, the SRS-CSPSP suggests taking ED 41 out of the Convergence Catalogue. This topic is not relevant for the public sector and can be covered by IPSAS 3. If such complex IAS/IFRS that are of little relevance for the public sector are taken over in IPSAS, acceptance of the entire suite of IPSAS is at risk. In addition the cost-benefit question arises in the implementation of such IPSAS. • As the „Convergence Project“ has now been completed, in future emphasis should be laid on sector specific questions. For example an IPSAS for Entity Combinations from Non-exchange Transactions, which are relevant in the public sector.
12	Comptroller General, British Columbia (Canada)	<p>The purpose of government financial reporting is to determine the cost of program delivery and reinvestment in infrastructure. The exposure draft is conceptually inconsistent with the purposes of government financial statements and the needs of the users of financial statements. The information requirements of the users of public and private sector financial statements are fundamentally different. The implementation of the proposed standards provides no demonstrable benefits to the users of public sector financial statements who look to financial statements for transparency and accountability rather than to make economic decisions. IPSASB guidance on this topic should be deferred until the work that is currently underway on its conceptual framework is complete. It is imperative that IPSAS standards are first consistent with its final conceptual framework; this will help assure governments that accounting standards are conceptually sound and that they will not be faced with significant revisions to a new standard shortly after adoption.</p>

#	RESPONDENT NAME	KI #2 SCOPE LIMITATION
7	Australian Accounting Standards Board	<p>However, the AASB is concerned with the proposal to limit the scope of the proposed IPSAS to entity combinations from exchange transactions. The AASB believes that the exchange/non-exchange distinction would be difficult to apply in practice, because of the difficulty in distinguishing between an amount paid in exchange for goodwill and an amount transferred in a non-exchange transaction.</p> <p>The AASB recommends instead that entity combinations from non-exchange transactions be included within the Standard's scope, and that the common control scope exclusion in IFRS 3 is retained. The AASB believes that this approach would better comply with the policy of only changing IFRSs in the convergence project when needed for public sector specific reasons. The AASB acknowledges that there may be practical issues in identifying entities or operations under common control. However, the AASB considers this is a jurisdictional issue that should not be addressed by the IPSASB as part of its convergence project.</p>
13	Joint Accounting Bodies (Australia)	<p>• <i>Scope</i></p> <p>The scope of the [proposed] Standard is limited to entity combinations from exchange transactions. The Joint Accounting Bodies do not support the decision that the scope of the [proposed] Standard be limited in this way. We are not aware of any public sector reason to justify the decision. Instead, we strongly suggest that the scope be expanded to enable the [proposed] Standard to apply to entity combinations from both exchange and non-exchange transactions, and that the common control scope exclusion in IFRS 3 be retained. We note that the Australian Accounting Standards Board's equivalent Standard to IFRS 3, AASB 3 <i>Business Combinations</i>, excludes from its scope a restructure of administrative arrangements.</p>

#	RESPONDENT NAME	KI #3 GOODWILL
2	Public Sector Accounting Board (Canada)	<p><u>Gain on Bargain Purchase</u></p> <p>ED 41 proposes recognition of gains on bargain purchases arising from acquisitions in surplus or deficit at the date of acquisition. PSA Handbook is silent on the accounting treatment for bargain purchase arising from acquisition of government business enterprises but requires gains on bargain purchase arising from acquisition of a government unit be eliminated through adjustment to the value of non-monetary assets acquired. This treatment is based on PSAB's view that net assets acquired should not be recorded at amounts higher than the purchase costs to the government.</p> <p>...</p> <p>Goodwill Arising From Acquisition of a Non-Cash Generating Operation</p> <p>PSAB staff support the accounting treatments for goodwill arising from acquisitions of cash-generating operation and non-cash generating operation proposed in ED 41. With the different purposes of acquiring a cash and a non-cash generating operation and the different nature of the acquirees, the different accounting treatments for goodwill proposed in ED 41 reflect the different economic substance of the acquisitions (as described in PS 2510, <i>Additional Areas of Consolidation</i>, paragraph 24, quoted below).</p>

“A purchase premium arising on acquisition of a governmental unit would be charged to expenses in the period of acquisition because the future net cash flows associated with a governmental unit, by definition, are unlikely to indicate that the purchase premium has been paid for anything but policy reasons. Governmental units receive funding from the government in order to pursue their activities and meet their debt requirements. Consequently, it is unlikely that the portion of the purchase cost related to the purchase premium could be tied to projected future profits from revenues received from sources external to the government reporting entity and so should be a cost of the period of acquisition.”

However, PSAB staff is concerned where the accounting treatment for goodwill arising from acquisition of a **non-cash** generating operation is presented in ED 41. This accounting treatment is addressed in the Application Guide (paragraph AG 41), rather than in the Standard itself (for example, under the section “Recognizing and measuring goodwill or a gain from a bargain purchase”). No reference is made for this departure from the general goodwill recognition principle (which is stated in paragraph 38) or from IFRS 3, except that a sentence “*paragraphs AG40-AG45 provide related application guidance*” is included at the end of paragraph 39. Readers of this Standard who do not see the need to go to the more detailed Application Guidance will likely assume that goodwill arising from all acquisitions (regardless of the nature of acquirees) will be recognized. Though the “expense” treatment for “purchase premium” represents a deviation from IFRS 3, it is not mentioned in the “Basis for Conclusions”, which addresses major differences between IFRS 3 and ED 41.

The wording in paragraph AG 41, “*Occasionally, an acquirer will make an acquisition of a non-cash-generating operation, in which the aggregate of the amounts in paragraph 38(a) exceeds the amount in paragraph 38(b)*”, appears to imply that most entity combination transactions in the public sector are acquisitions of cash-generating operations. PS 2510.11 also recognizes that only “*in the rare circumstances when a government acquires a government unit, the acquisition is normally made for policy reasons.*” Though occurred occasionally, in PSAB staff’s view, the “expense” treatment of “purchase premium” arising from an acquisition of a non-cash-generating operation is a significant deviation from IFRS 3 and the general recognition principle for goodwill and should be addressed in the Standard.

Bargain purchase, is also recognized in ED 41 as arising from entity combinations occasionally, the treatment of which is addressed in the Standard (in paragraph 40, quoted below) and not the Application Guidance.

“Occasionally, an acquirer will make a bargain purchase, which is an entity combination in which the amount in paragraph 38(b) exceeds the aggregate of the amounts specified in paragraph 38(a).”

		<p>While the Application Guidance is an integral part of the Standard, not addressing this differential treatment in the Standard and the Basis for Conclusions can be potentially misleading. If there is an acquisition of a non-cash generating operation and goodwill arises, the possible impact of the different accounting treatments on a public sector entity's financial statements can be significant. PSAB staff recommend that paragraph AG 41 be included in the Standard to ensure that it gets the necessary attention, similar to exceptions to the recognition and measurement principles which are described in the Standard. It is also recommend that this difference be highlighted in the "Basis for Conclusions".</p>
6	HoTARAC (Australia)	<p>HoTARAC is of the opinion that the use of goodwill, although consistent with IFRS 3, lacks meaning in the not-for-profit public sector context. HoTARAC considers that the difference between consideration transferred (and other interests in the acquiree) and net identifiable assets acquired is unlikely to reflect anticipated future economic benefits or even service potential in a not-for-profit public sector context. As goodwill is subject to impairment testing, HoTARAC's concerns in regards to goodwill is to some extent mitigated, however, HoTARAC is of the view that the IPSASB should consider undertaking a project to review accounting for goodwill in the public sector. In HoTARAC's opinion, a goodwill project would complement IPSASB's current project on accounting for intangible assets.</p>
9	Accounting Standards Board (South Africa)	<p>In the public sector, it is common for entities to operate as non-cash generating institutions. When a public sector entity acquires a cash-generating operation through an exchange transaction, the acquired combination may then form part of the entity's non-cash-generating operations. Paragraph .38 highlights the fact that the subsequent measurement and accounting of goodwill is addressed in IPSAS 26, but it is not clear whether those principles should also be applied to the subsequent measurement and accounting of goodwill under the circumstances outlined above, i.e. when the combination is subsequently incorporated as part of the non-cash-generating activities. Currently IN12 explains that the impairment of non-cash-generating assets is dealt with in IPSAS 21, but no guidance is provided in IPSAS 21 or in the consequential amendments proposed to IPSAS 21 (see Appendix B) to explain the impairment of goodwill from non-cash-generating assets, or how goodwill should be impaired in the circumstances outlined above. We propose that the proposed IPSAS should address these matters by clarifying the principles and explaining the reasoning thereof in the Basis for Conclusions.</p> <p>...</p> <p>AG32 includes the following statement "the acquirer will determine whether any goodwill recognized is impaired in accordance with IPSAS 21 <i>Impairment of Non-Cash-Generating Assets</i> and IPSAS 26 <i>Impairment of Cash-Generating Assets</i>".</p> <p>However, no consequential amendments are proposed to IPSAS 21 with regards to the impairment of goodwill. The principle in paragraph .38 requires entities to allocate goodwill acquired in an entity combination to each of the acquirer's cash-generating units or groups of cash-generating units that is expected to benefit from the synergies of the combination. IPSAS 21 does not acknowledge non-cash-generating units, and hence the principles proposed in</p>

		<p>IPSAS 26 could not be applied. We propose that the inconsistency between AG32, IN12 and paragraph .38 should be clarified. (Also refer to our comment on paragraph .38 above).</p> <p>AG41 establishes the principles for the acquisition of a non-cash-generating operation. We are of the view that this principle should be included in the proposed IPSAS and not only in the application guidance. Furthermore, the Basis for Conclusions should summarise and explain the IPSASB's view and reasoning behind this principle.</p>
12	Comptroller General, British Columbia (Canada)	<p>Given the objectives of government, I have several concerns regarding this Exposure Draft:</p> <p>...</p> <ul style="list-style-type: none">• <u>Goodwill should not be recognized by government.</u> A purchase premium arising on acquisition of a governmental unit should be charged to expenses in the period of acquisition. The future net cash flows associated with a governmental unit, by definition, are likely to indicate that the purchase premium has been paid for policy reasons. It is highly unlikely that a purchase premium has any future economic benefit to the acquiring government.

BREAKDOWN OF RESPONDENTS

Purpose of this Paper:

The following is staff's analysis of the 13 responses received to ED 41, "Entity Combinations from Exchange Transactions." It is not intended as a replacement for an analysis of the substance of the responses.

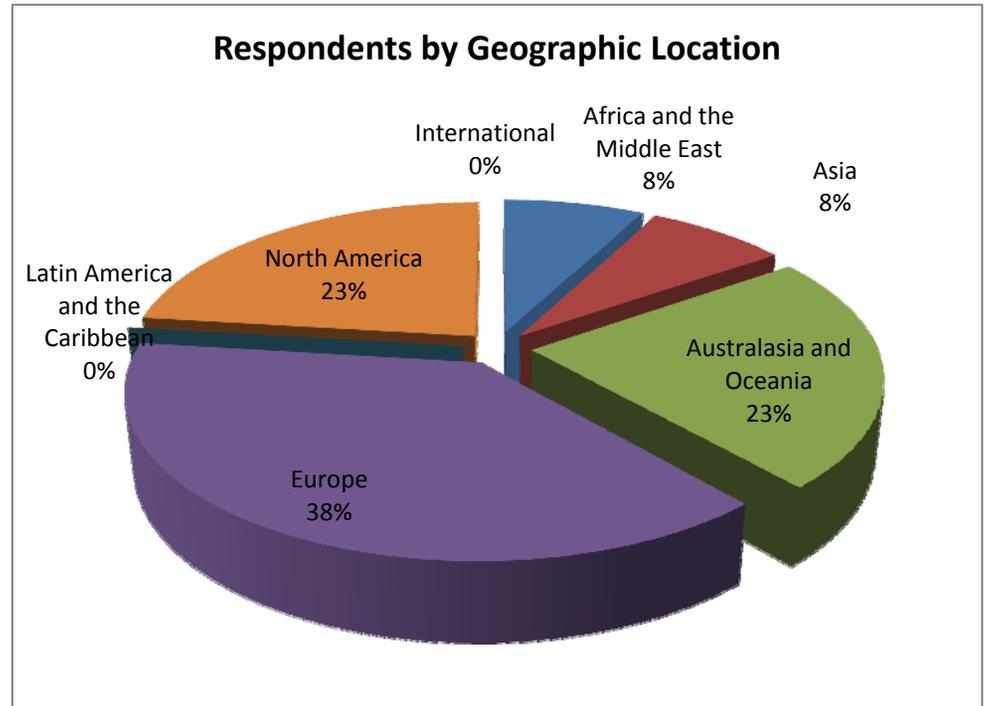
Copies of the responses are provided as Agenda paper 8.4.

List of Respondents:

Response #	Respondent Name
1	Comité des Normes des Comptabilité Publique (France)
2	Public Sector Accounting Board (Canada)
3	Accounting Standards Board (UK)
4	Japanese Institute of Certified Public Accountants
5	Dr. Joseph Maresca
6	HoTARAC (Australia Heads of Treasuries Accounting and Reporting Advisory Committee)
7	Australian Accounting Standards Board
8	Swiss Public Sector Financial Reporting Advisory Committee (SRS-CSPCP)
9	Accounting Standards Board (South Africa)
10	Audit Commission (UK)
11	CIPFA (UK)
12	Comptroller General, British Columbia (Canada)
13	Joint Accounting Bodies (Australia)

Geographic Breakdown:¹

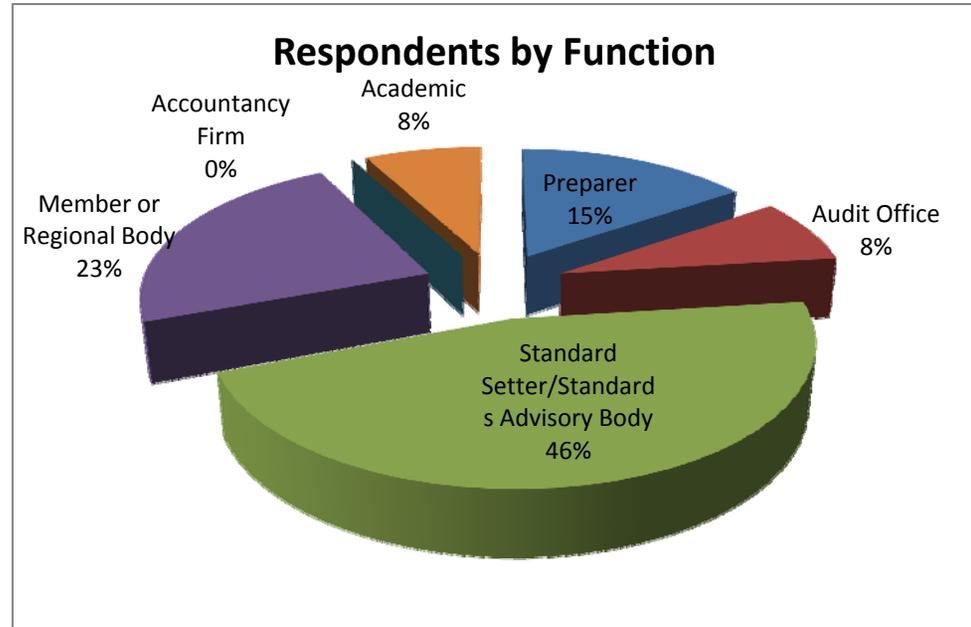
Location	Response #s	Total
Africa and the Middle East	9	1
Asia	4,	1
Australasia and Oceania	6, 7, 13	3
Europe	1, 3, 8, 10, 11	5
Latin America and the Caribbean		0
North America	2, 5,12	3
International		0
Total		13



¹ The geographic breakdown used is the same as that used in IPSASB’s Agenda Paper 1.4, “Report on IPSASB Communications and Liaison Activities” and in the IFAC document, “Call for Nominations for IFAC Boards and Committees in 2010,” at http://web.ifac.org/download/2_Call_for_Nominations_2010.pdf

Functional Breakdown:

Function	Response #s	Total
Preparer	6, 12	2
Audit Office	10	1
Standard Setter/Standards Advisory Body	1, 2, 3, 7, 8, 9	6
Member or Regional Body	4, 11, 13	3
Accountancy Firm		0
Academic	5	1
Total		13



Linguistic Breakdown:

Language	Response #s	Total
English-Speaking	2, 3, 5, 6, 7, 9, 10, 11, 12, 13	10
Non-English Speaking	1, 4, 8	3
Combination		0
Total		13

