



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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**Agenda Item
10**

Date: October 19, 2010
Memo to: Members of the IPSASB
From: Annette Davis
Subject: Entity Combinations

Objective of this Session

- To **review** responses to the request for comments on the revised Project Brief on Entity Combinations;
- To **approve** the revised Project Brief on Entity Combinations;
- To **discuss and provide feedback** on aspects of Key Issue 1 “Does the Working Definition of an Entity Combination Encompass all the Types of Entity Combinations Intended by the IPSASB and Therefore Does it Establish the Intended Scope of the Project?”

Agenda Material

- 10.1 Revised draft Project Brief – clean
- 10.2 Revised draft Project Brief – marked-up
- 10.3 Table of Members’ and TAs’ Comments and Proposed Response
- 10.4 Issues Paper on aspects of Key Issue 1
- 10.5 Minutes from Previous Meetings

Revised Project Brief

1. At its June 2010 meeting, the IPSASB agreed that the Project Brief for the entity combinations project needed to be revised to reflect the decision at the April 2010 meeting, to consider all types of entity combination in the public sector. Agenda Paper 10.5 provides extracts of the minutes from meetings where this project has been discussed.
2. Staff received six responses to the request for comments on the revised Project Brief. These are set out in Agenda Paper 10.3. In addition, Staff received comments from other Staff. The Project Brief has been updated for these comments and is shown in clean format at Agenda Paper 10.1 and marked-up format at Agenda Paper 10.2.

Question:

Does the IPSASB agree with the revised Project Brief?

Issues Paper on Aspects of Key Issue 1

3. Using the Key Issues set out in the revised Project Brief, Agenda Paper 10.4 discusses aspects of Key Issue 1 relating to the scope of the entity combinations project.



INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

PROJECT BRIEF AND OUTLINE

1. Subject—Entity Combinations

- 1.1 This project will create requirements and guidance on accounting for entity combinations.
- 1.2 The IPSASB initially approved the Project Brief for the Entity Combinations project in March 2007. In developing the revised Project Brief, the IPSASB considered whether the project should be an IFRS convergence project. However, the IPSASB is of the view that a wider notion of entity combinations is required for the public sector than that reflected in the IASB International Financial Reporting Standard (IFRS) 3, “Business Combinations.” This is because IFRS 3 is specifically aimed at combinations of for-profit private sector business entities. Public sector entities primarily undertake activities to provide goods and services to the community, rather than for a commercial return. Consequently, business combinations as reflected in IFRS 3, do not embrace the full range (and arguably the most frequent types) of entity combinations that occur in the public sector. Therefore, this project is not an IFRS convergence project.
- 1.3 Because this project addresses the wider notion of bringing together separate entities into one reporting entity, the working definition encompasses, but is not limited to, the obtaining of control. The working definition of an entity combination is:

“The bringing together of separate entities or operations into one reporting entity.”

- 1.4 This working definition means that the following types of entity combinations will be included in the scope of the project:
 - 1.4.1 An existing or newly established entity taking control of one or more entities;
 - 1.4.2 An existing or newly established entity taking control of the operations of another entity or entities; or
 - 1.4.3 Two or more entities combining.

2. Project Rationale and Objectives

- 2.1 Entity combinations are prevalent in the public sector as governments and public sector entities seek to increase the efficiency and effectiveness of the services they provide or for other policy objectives. They can take many forms in addition to the type of entity combination described in IFRS 3.

- 2.2 Currently, limited guidance exists on how to account for the broad range of entity combinations encompassed within this project.

International Guidance on this Topic

- 2.3 IFRS 3 provides guidance on business combinations for business entities in the for-profit private sector where an acquirer gains control of an acquiree. It excludes from its scope combinations of businesses under common control.

National Guidance on this Topic

- 2.4 Many National Standards Setters (NSS) have guidance on transactions or other events in which there is a combination of two or more business entities. However, it appears that few, if any, NSS have in place authoritative requirements that deal with the full range of entity combinations that may occur in the public sector. The project development will include identification and consideration of authoritative guidance in IPSASB Member's and other jurisdictions, as appropriate.

(a) Issues identified

- 2.5 There are a number of issues that will need to be considered in progressing this project. The major issues are:

- 2.5.1 Does the working definition of an entity combination encompass all the types of entity combinations intended by the IPSASB and therefore does it establish the intended scope of the project?

- 2.5.2 What is the appropriate accounting treatment for each type of entity combination on initial recognition, including:

- (a) What is the appropriate measurement basis for each type of entity combination?
- (b) What is the appropriate accounting treatment of the difference arising from the net assets received or net liabilities assumed and the consideration transferred (if any)?
- (c) Whether the absence of an "owner", as that term is used for financial reporting purposes by business entities, will have an effect on the accounting treatment of certain types of entity combinations in the public sector.

- 2.5.3 What is the appropriate presentation and disclosure for the parties involved in each type of entity combination?

- (a) Should pro forma comparative financial information be permitted and/or required?

(b) Objectives to be achieved

- 2.6 The ultimate objective of the project is to develop a comprehensive IPSAS (or IPSASs) that specifies requirements for financial reporting for each type of entity combination in the public sector.

2.7 The intermediate objective is to produce a Consultation Paper. The Consultation Paper will address possible accounting treatments for the types of entity combinations listed in paragraph 1.4 above.

(c) Link to IFAC and IPSASB Strategic Plans

i. Link to IPSASB Strategy

2.8 This project was identified in the IPSASB Strategy and Operational Plan 2007–2009, as being a priority because the IPSASB does not currently have any guidance on this topic. The project initially split entity combinations between exchange and non-exchange entity combinations so that a limited convergence project with IFRS 3, “Business Combinations” could be undertaken. However, at its April 2010 meeting, the Board considered that this distinction cannot be clearly articulated and so agreed to reconsider all types of entity combinations at the same time.

2.9 In the draft IPSASB Strategy and Operational Plan 2010–2012, the strategic areas of focus include the need to address public sector critical projects. Entity combinations are an important aspect of public sector arrangements.

ii. Link to IFAC Strategic Plan

2.10 Issuing International Public Sector Accounting Standards (IPSAS) is a primary role of the IPSASB. The development of accounting guidance on entity combinations supports IFAC’s mission of serving the public interest by contributing to its Strategic Theme of “Recognition as the International Standard Setter” for governmental financial reporting.

3. Outline of the Project

(a) Project Scope

3.1 The scope of this project is to determine the appropriate accounting treatment of each type of entity combination in the consolidated and separate financial statements of the entity which acquires or otherwise gains control of the operations of another entity or part thereof or the entity resulting from the combining of entities. It includes entity combinations undertaken with or without the transfer of consideration, including entity combinations under common control and entity combinations not under common control, as follows.

3.1.1 Combinations of entities, operations, districts or regions. Terms used to refer to these types of combinations, in some jurisdictions, include amalgamations or mergers;

3.1.2 Changes in the structure of public sector entities or operations, either within an economic entity or between economic entities. These changes encompass, for example, combinations of existing departments, creation of new departments and transfer of operations between departments. In some jurisdictions, these types of combinations are referred to as

reorganizations, restructures, reconstructions, realignments or administrative arrangements;

- 3.1.3 Acquisition of entities or operations on a commercial basis; and
- 3.1.4 Acquisition of entities or operations on a non-commercial basis.
- 3.2 The scope of this project does not include:
 - 3.2.1 The formation of a joint venture; and
 - 3.2.2 The transfer of an asset or a group of assets that do not constitute an entity or an operation.

(b) Major Problems and Key Issues that Should be Addressed

Key Issue #1—Does the working definition of an entity combination encompass all the types of entity combinations intended by the IPSASB and therefore does it establish the intended scope of the project?

- 3.3 A key issue will be to determine whether the working definition of an entity combination encompasses all the types of entity combinations intended by the IPSASB and therefore whether it establishes the intended scope of the project. In agreeing the definition of an entity combination it will also be necessary to establish definitions and explain the terminology used, such as the meaning of “common control.”

Key Issue #2—What is the appropriate accounting treatment for each type of entity combination on initial recognition?

- 3.4 A key issue will be to determine the appropriate accounting treatment in the recipient’s or acquirer’s consolidated financial statements for each type of entity combination. The recipient or acquirer could recognize assets and liabilities currently recognized in the financial statements of the transferee or acquiree. Or the recipient or acquirer could recognize all assets received and liabilities assumed in the transfer, i.e., the recipient or acquirer may recognize some assets and liabilities that the transferee or acquiree had not previously recognized as assets and liabilities in its financial statements. For example, the recognition of an intangible asset that the transferee or acquiree did not recognize as an asset in its financial statements because it developed it internally. Additionally, the appropriate accounting treatment in the recipient’s or acquirer’s separate financial statements will need to be determined.

Key Issue #2(a)—What is the appropriate measurement basis for each type of entity combination?

- 3.5 A key issue will be to determine the measurement basis for the assets received and liabilities assumed, e.g., at carrying amount or at fair value. The recipient or acquirer could measure the assets received and liabilities assumed from the transferee or acquiree at fair value. Alternatively, the combination could be a trigger to recognize the fair value of all the assets and liabilities in the economic entity or group, so called “fresh start” accounting.

Key Issue #2(b)—What is the appropriate accounting treatment of the difference arising from the net assets received or net liabilities assumed and the consideration transferred (if any)?

- 3.6 A key issue will be to determine the accounting treatment of the difference arising from the net assets received or net liabilities assumed and the consideration transferred (if any). For example, where the recipient entity receives net assets or assumes net liabilities, then the balancing entry could be either a contribution from an owner or a distribution to an owner, or revenue or expense (directly into the statement of financial performance or directly to net assets/equity or a combination of both).

Key Issue #2(c)—Whether the absence of an “owner,” as that term is used for financial reporting purposes by business entities, will have an effect on the accounting treatment of certain types of entity combinations in the public sector?

- 3.7 A key issue will be to determine whether the owners of the entities involved in the combination can be identified and whether, as is likely to often be the case, the absence of an owner, as that term is used for financial reporting purposes by business entities, has an effect on the accounting treatment of certain types of entity combination.

Key Issue #3—What is the appropriate presentation and disclosure for each type of entity combination?

- 3.8 A key issue will be to determine if the current presentation requirements in IPSAS 1, “Presentation of Financial Statements” are appropriate or whether they need to be amended. Disclosures specifically relating to each type of entity combination transaction or other event will need to be determined.

Key Issue #3(a)—Should pro forma comparative financial information be permitted and/or required?

- 3.9 A key issue will be to determine whether the recipient’s or acquirer’s consolidated and separate financial statements should also include pro forma information as if the acquired entity had been acquired as at the beginning of the most recent comparative period.

4. Describe the Implications for any Specific Persons or Groups

(a) Relationship to IASB

- 4.1 This project will encompass combinations of entities under common control. The IASB has identified an item “Common Control Transactions” on the Research and Other Projects section of its Work Plan. The project’s scope is to explore the definition of common control and the methods of accounting for business combinations under common control—in the acquirer’s consolidated and separate financial statements. The project will also consider the accounting for demergers, such as the spin-off of a subsidiary or business. This project is currently deferred and is unlikely to be placed on the active agenda for some time.

(b) Relationship to Other Standards, Projects in Process or Planned

4.2 Dependent upon the output of this project, there may be implications for several IPSASs such as IPSAS 23, “Revenue from Non-exchange Transactions (Taxes and Transfers)” and IPSASs 28–30 on financial instruments. The following identifies some of those IPSASs. As the project develops, potential implications for other IPSASs may also be identified. At this stage (October 2010), there are no IFRIC Interpretations that are relevant to this project. The actions of IFRIC will be monitored as the project develops.

Consequential Amendments

4.3 The following IPSASs are likely to be directly affected by this project and may require amendment as a consequence – to be monitored as the project develops.

i. IPSAS 21, “Impairment of Non-Cash-Generating Assets”

4.4 IPSAS 21, “Impairment of Non-Cash-Generating Assets” is adapted from IAS 36, “Impairment of Assets.” Involvement in an entity combination may need to be identified as a trigger for an impairment test where the measurement of the net assets received and net liabilities assumed are at carrying amount.

ii. IPSAS 26, “Impairment of Cash-Generating Assets”

4.5 IPSAS 26, “Impairment of Cash-Generating Assets” does not include goodwill or cash-generating units in its scope. This Standard is also adapted from IAS 36. IAS 36 includes extensive requirements and guidance on the impairment of goodwill and cash-generating units. When IPSAS 26 was developed, the IPSASB concluded that goodwill and cash-generating units should not be included in the scope of this Standard until such a time that the IPSASB has a Standard (or Standards) for entity combinations. Consequently, IPSAS 26 will need to be reviewed as part of this project. Furthermore, where the measurement of the assets received and liabilities assumed in an entity combination are at carrying amount, it may be appropriate to consider this circumstance as a potential indicator of impairment.

iii. IPSAS 31, “Intangible Assets”

4.6 IPSAS 31, “Intangible Assets” does not include intangible assets or goodwill acquired in a business combination in its scope. This Standard is adapted from IAS 38, “Intangible Assets,” which contains requirements and guidance on the recognition and measurement of these items. When IPSAS 31 was being developed, the IPSASB concluded that intangible assets or goodwill acquired in a business combination should not be included in the scope of this Standard until such a time that the IPSASB has a Standard for entity combinations. Consequently, IPSAS 31 will need to be reviewed as part of this project.

Other IPSASs Not Directly Related to this Project but need to be Monitored

4.7 The following IPSASs are unlikely to be directly affected as a consequence of this project. However, there may be some overlap and interaction, and gives an

opportunity to process needed and, arguably, related changes – to be monitored as the project develops.

iv. IPSAS 6, “Consolidated and Separate Financial Statements”

- 4.8 IPSAS 6, “Consolidated and Separate Financial Statements” requires that a controlled entity be excluded from the consolidated financial statements where there is evidence that (a) control is intended to be temporary because the controlled entity is acquired and held exclusively with a view to its disposal within twelve months from acquisition and (b) management is actively seeking a buyer.
- 4.9 IPSAS 6 is based upon the December 2003 version of IAS 27, “Consolidated and Separate Financial Statements.” The IASB removed this exemption from IAS 27 with the issue of IFRS 5, “Non-current Assets Held for Sale and Discontinued Operations” in March 2004. It is unclear as to whether or not there is a public sector specific reason for retention of the exemption in IPSAS 6. In addition, the IASB is currently revising IAS 27. It is expected that a revised Standard will be issued in Quarter 4, 2010. The IPSASB’s draft Work Plan for 2010–2012 potentially includes the revision of IPSAS 6 as part of the entity combinations project. The IASB project will need to be monitored for interaction with this project.
- 4.10 IPSAS 6 includes guidance on how to account for controlled entities in the consolidated and separate financial statements of a controlling entity. IPSAS 6 may also require amendment as the decisions made regarding each type of entity combination, i.e., the initial recognition and measurement of a controlled entity in the recipient’s consolidated and separate financial statements, may affect the subsequent accounting of this controlled entity. For example, it may be appropriate to reconsider whether GBEs should continue to be fully consolidated into the economic entity’s consolidated financial statements.

v. IPSAS 7, “Investments in Associates”

- 4.11 IPSAS 7, “Investments in Associates” is based upon IAS 28, “Investments in Associates” (2003). IAS 28 has been subsequently amended. This project may be the appropriate timing to revise IPSAS 7, at the same time as IPSAS 6 and IPSAS 8 are being revised. Note that the IPSASB’s draft Work Plan for 2010–2012 potentially includes the revision of IPSAS 7 as part of the entity combinations project.

vi. IPSAS 8, “Interests in Joint Ventures”

- 4.12 IPSAS 8, “Interests in Joint Ventures” is based upon IAS 31, “Interests in Joint Ventures.” The IASB is currently revising IAS 31 and it is expected that an amended Standard will be issued in Quarter 4, 2010. It may be appropriate to revise IPSAS 8 at the same time as IPSAS 6 and IPSAS 7, as they both deal with interests in other entities, as part of this project. Note that the IPSASB’s draft Work Plan for 2010–2012 potentially includes the revision of IPSAS 8 as part of

the entity combinations project. The IASB project will need to be monitored for interaction with this project.

(c) Other—Government Finance Statistics

4.13 One aspect of the IPSASB’s strategic theme of undertaking public sector specific projects is to consider convergence with the statistical basis of accounting where appropriate. This project will explore how entity combinations are accounted for under the statistical basis and whether there are opportunities for the accounting treatment to be similar to that used for the statistical basis of accounting. In addition, the project may also consider disclosures to assist users in reconciling differing requirements. This may result in a review of IPSAS 22, “Disclosure of Financial Information about the General Government Sector.”

5. Development Process, Project Timetable and Project Output

(a) Development Process

5.1 The development of outputs will be subject to the IPSASB’s formal due process. The issuance of documents for public comment will be subject to the usual IPSASB voting rules. As the project progresses, regular assessments will be made to confirm the proposed path in the project timetable remains the most appropriate.

(b) Project timetable

Major Project Milestones	Expected Completion
Present revised Project Brief	November 2010
Discussion of issues and development of a Consultation Paper (CP) (January–September 2011)	
Approve CP (6 month comment period)	September 2011
Review of responses to CP and development of an Exposure Draft or Drafts (April 2012–March 2013)	
Approve ED/EDs (4 month comment period)	March 2013
Review of responses to ED and development of a IPSAS/IPSASs	
Approve Final IPSAS /IPSASs	2014

5.2 The review of IPSASs 6–8 will commence when the review of responses to the CP has been completed and will be undertaken in the same time frame as the development of the entity combinations ED/EDs and issue of an IPSAS(s).

(c) Project output

5.3 The initial output will be a Consultation Paper. The ultimate output will be an IPSAS or IPSASs.

6. Resources Required

(a) Task Force/Subcommittee

6.1 A Task Force may be required to assist in providing a broad spectrum of the types of entity combinations that are undertaken.

(b) Staff

6.2 It is envisaged that 0.5 Full Time Equivalent (FTE) will be required to resource the project.

(c) Factors that might add to complexity and length

6.3 Factors that might add to the complexity and length of the project include:

6.3.1 The wide range of entity combinations undertaken in the public sector.

6.3.2 The relative lack of existing guidance on entity combinations in the public sector.

6.3.3 The interaction between this project and IPSAS 6.

6.3.4 The interaction between this project and the development of the Conceptual Framework.

7. Important Sources of Information that Address the Matter being Proposed

7.1 Potential sources of information regarding entity combinations include:

7.1.1 IFRS 3, “Business Combinations.”

7.1.2 The IASB’s currently deferred project on Common Control Transactions.

7.1.3 National Standard Setters guidance on entity combinations.

7.1.4 The Government Finance Statistics Manual (2001).

7.1.5 The System of National Accounts (SNA) 2008.



INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

PROJECT BRIEF AND OUTLINE

1. Subject—Entity Combinations

- 1.1 This project will create requirements and guidance on accounting for entity combinations.
- 1.2 The IPSASB initially approved the Project Brief for the Entity Combinations project in March 2007. In developing the revised Project Brief, the IPSASB considered whether the project should be an IFRS convergence project. However, the IPSASB is of the view that a wider notion of entity combinations is required for the public sector than that reflected in the IASB International Financial Reporting Standard (IFRS) 3, “Business Combinations.” This is because the public sector primarily undertakes activities to provide goods and services to the community, rather than for a commercial return and IFRS 3 is specifically aimed at combinations of for-profit private sector business entities. Public sector entities primarily undertake activities to provide goods and services to the community, rather than for a commercial return. Consequently, business combinations as reflected in IFRS 3, do not embrace the full range (and arguably the most frequent types) of entity combinations that occur in the public sector. Therefore, this project is not an IFRS convergence project. The phrase “entity combinations” is derived from the IASB’s definition of a business combination in IFRS 3, “Business Combinations” issued in March 2004.
- ~~1.3 The IPSASB agreed that the term “entity” should replace “business” because the public sector primarily undertakes activities for community or social benefit, rather than for a commercial return. This means that most combinations will involve non-cash-generating operations. Only occasionally are there combinations involving cash-generating operations.~~
- ~~1.4 The definition of a business combination in the March 2004 version of IFRS 3 is:
“The bringing together of separate entities or businesses into one reporting entity.”~~
- ~~1.5 The IASB subsequently issued a revised version of IFRS 3 in January 2008 which included a new definition of business combination. The change in the definition has narrowed the meaning of the term “business combination.” For users of IFRSs, this means that a business combination is only considered to be an acquisition, where an acquirer gains control of an acquiree.~~
- 1.36 For the purpose of this revised Project Brief, Because this project addresses it is the wider notion of bringing together separate entities into one reporting entity that this project addresses, the working definition encompasses, but is not limited to, the obtaining of control because the majority of the transactions or events that

~~are entity combinations in the public sector will not be acquisitions.~~ The working definition of an entity combination is:

“The bringing together of separate entities or operations into one reporting entity.”

1.4 ~~This working definition means that the following types of entity combinations will be included in the scope of the project:~~

~~1.4.2 An existing or newly established entity taking control of one or more entities;~~

~~1.4.2 An existing or newly established entity taking control of the operations of another entity or entities; or~~

~~1.4.3 Two or more entities combining.~~

2. Project Rationale and Objectives

2.1 Entity combinations are prevalent in the public sector as governments and public sector entities ~~undertake reorganizations and reconstructions seek~~ to increase the efficiency and effectiveness of the services they provide ~~or for other policy objectives.~~ ~~Entity combinations may be described as a merger, a union of districts or regions, an amalgamation or an administrative arrangement.~~ ~~They usually can take many forms in addition to the type of entity combination described in IFRS 3, the form of:~~

~~An existing or newly established entity taking control of another entity or entities;~~

~~An existing or newly established entity taking control of a part of another entity’s or entities’ activities; or~~

~~Two or more entities combining to form a new entity.~~

2.2 Currently, limited guidance exists on how to account for ~~the broad range of~~ entity combinations ~~encompassed within this project.~~

International Guidance on this Topic

2.3 IFRS 3 provides guidance on business combinations for ~~business entities in the~~ for-profit private sector ~~entities~~ where an acquirer gains control of an acquiree. It excludes from its scope combinations of businesses under common control.

National Guidance on this Topic

2.4 ~~Many~~ ~~Some~~ National Standards Setters (NSS) have guidance on transactions or other events in which there is a combination of two or more business ~~entities.~~ ~~However, it appears that few, if any, NSS have in place authoritative requirements that deal with the full range of entity combinations that may occur in the public sector. The project development will include identification and consideration of authoritative guidance in IPSASB Member’s and other jurisdictions, as appropriate.~~ ~~that, prior to the combination, were not under common control.~~

~~Merger accounting or the pooling of interests method is usually required for these types of combinations. This guidance is sometimes applied to the restructuring of entities or businesses within a group (economic entity), i.e., entities under common control.~~

(a) Issues identified

2.5 There are a number of issues that will need to be considered in progressing this project. The major issues are:

2.5.1 ~~What is Does~~ the working definition of an entity combination encompass all the types of entity combinations intended by the IPSASB and therefore does it establish the intended scope of the project?

2.5.2 What is the appropriate accounting treatment for ~~an~~ each type of entity combination on initial recognition, including?:

~~2.5.3~~ (a) What is the appropriate measurement basis for ~~an~~ each type of entity combination?

~~2.5.4~~ (b) What is the appropriate accounting treatment of the difference arising from the net assets received or net liabilities assumed and the consideration transferred (if any)?

(c) Whether the absence of an “owner,” as that term is used for financial reporting purposes by business entities, purposes, will have an effect on the accounting treatment of each certain types of entity combinations in the public sector.

~~2.5.35~~ What is the appropriate presentation and disclosure for the parties involved in each type of entity combination? Should the comparative amounts be restated?

(a) Should pro forma comparative financial information be permitted and/or required?

~~2.5.6~~ What is the appropriate presentation and disclosure for an entity combination? Should the comparative amounts be restated?

(b) Objectives to be achieved

2.6 The ultimate objective of the project is to develop a comprehensive Standard IPSAS (or ~~Standards~~ IPSASs) that specifies requirements for financial reporting on accounting for all each types of entity combinations in the public sector.

2.7 The intermediate objective is to produce a Consultation Paper. The Consultation Paper will address possible accounting treatments for the types of entity combinations listed in paragraph 1.4 above analyze the structure of the public sector and the types of entity combinations that are undertaken. It will explore the guidance available internationally and nationally for entity combinations and highlight the issues which need to be addressed.

(c) **Link to IFAC and IPSASB Strategic Plans**

i. *Link to IPSASB Strategy*

- 2.8 This project was identified in the IPSASB Strategy and Operational Plan 2007–2009, as being a priority because the IPSASB does not currently have any guidance on this topic. The project initially split entity combinations between exchange and non-exchange entity combinations so that a limited convergence project with IFRS 3, “Business Combinations” could be undertaken. However, at its April 2010 meeting, the Board considered that this distinction cannot be clearly articulated and so agreed to reconsider all types of entity combinations at the same time.
- 2.9 In the draft IPSASB Strategy and Operational Plan 2010–2012, the strategic areas of focus include the need to address public sector critical projects. Entity combinations are an important aspect of public sector arrangements.

ii. *Link to IFAC Strategic Plan*

- 2.10 Issuing International Public Sector Accounting Standards (IPSAS) is a primary role of the IPSASB. The development of accounting guidance on entity combinations supports IFAC’s mission of serving the public interest by contributing to its Strategic Theme of “Recognition as the International Standard Setter” for governmental financial reporting.

3. Outline of the Project

(a) **Project Scope**

- 3.1 The scope of this project is to determine the appropriate accounting treatment of an each type of entity combination in the recipient’s or acquirer’s consolidated and separate financial statements of the entity which acquires or otherwise gains control of the operations of another entity or part thereof, i.e., the entity that obtains control of the operation or entity transferred, or the entity resulting from the combining of entities. It includes entity combinations undertaken with or without the transfer of consideration, including entity combinations under common control, and entity combinations not under common control and entity combinations undertaken with or without the transfer of consideration, as follows.
- 3.1.1 Combinations of entities, operations, districts or regions. Terms used to refer to these types of combinations, in some jurisdictions, include amalgamations or mergers;
- 3.1.2 Changes in the structure of public sector entities or operations, either within an economic entity or between economic entities. These changes encompass, for example, combinations of existing departments, creation of new departments and transfer of operations between departments. In some jurisdictions, these types of combinations are referred to as

reorganizations, restructures, reconstructions, realignments or administrative arrangements;

3.1.3 Acquisition of entities or operations on a commercial basis; and

3.1.4 Acquisition of entities or operations on a non-commercial basis.

3.2 The ~~is~~ scope of this project does not include:

3.2.1 The formation of a joint venture; and

3.2.2 The transfer of an asset or a group of assets that do not constitute an entity or an operation.

(b) Major Problems and Key Issues that Should be Addressed

Key Issue #1—~~What is Does~~ the working definition of an entity combination encompass all the types of entity combinations intended by the IPSASB and therefore does it establish the intended scope of the project?

3.3 A key issue will be to determine whether the appropriate definition of an entity combination~~working definition of an entity combination~~ encompasses all the types of entity combinations intended by the IPSASB and therefore whether it establishes the intended scope of the project. ~~– Note that this Project Brief uses a working definition in order to get the project started. In addition, other key~~ In agreeing the definition of an entity combination it This Key Issue will also be necessary to establish definitions and include an explain the terminology used, and consideration of proposed definitions need to be determined, such as the meaning of “common control.”

Key Issue #2—What is the appropriate accounting treatment for ~~an~~ each type of entity combination on initial recognition?

3.4 A key issue will be to determine the appropriate accounting treatment in the recipient’s or acquirer’s consolidated ~~and separate~~ financial statements for ~~an~~ each type of entity combination. The recipient or acquirer recognition could be of existing recognize assets and liabilities currently recognized in the financial statements of the transferee or acquiree. Or the recipient or acquirer could recognize, or all assets received and liabilities assumed in the transfer, i.e., the recipient or acquirer may recognize some assets and liabilities that the transferee or acquiree had not previously recognized as assets and liabilities in its financial statements. For example, the recognition of an intangible asset that the transferee or acquiree did not recognize as an asset in its financial statements because it developed it internally. Additionally, the appropriate accounting treatment in the recipient’s or acquirer’s separate financial statements will need to be determined.

Key Issue #~~2(a)~~³—What is the appropriate measurement basis for ~~an~~ each type of entity combination?

3.5 A key issue will be to determine the measurement basis for the assets received and liabilities assumed, e.g., at carrying amount or at fair value. Where the

measurement of the assets received and liabilities assumed are at carrying amount, how does an entity determine that the carrying amounts are not overstated?—The recipient or acquirer could measure ~~Where the measurement of~~ the assets received and liabilities assumed ~~are from the transferee or acquiree~~ at fair value, ~~does this recognition apply to the transferee’s assets and liabilities only, or, is~~ Alternatively, the combination could be a trigger to recognize the fair value of all the assets and liabilities in the economic entity or group, so called “fresh start” accounting.?

Key Issue #2(b)4—What is the appropriate accounting treatment of the difference arising from the net assets received or net liabilities assumed and the consideration transferred (if any)?

- 3.6 A key issue will be to determine the accounting treatment of the difference arising from the net assets received or net liabilities assumed and the consideration transferred (if any). ~~Assuming that~~ For example, where the recipient entity receives net assets or assumes net liabilities, then the balancing entry could be either a contribution from an owner or a distribution to an owner, or revenue or expense (directly into the ~~income statement~~ statement of financial performance or directly to net assets/equity or a combination of both).

Key Issue #2(c)—Whether the absence of an “owner,” as that term is used for financial reporting purposes by business entities, will have an effect on the accounting treatment of certain types of entity combinations in the public sector?

- 3.7 A key issue will be to determine whether the owners of the entities involved in the combination can be identified and whether, as is likely to often be the case, the absence of an owner, as that term is used for financial reporting purposes by business entities, has an effect on the accounting treatment of certain types of entity combination.

Key Issue #36—What is the appropriate presentation and disclosure for ~~an~~ each type of entity combination?

- 3.8 A key issue will be to determine if the current presentation requirements in IPSAS 1, “Presentation of Financial Statements” are appropriate or whether they need to be amended. Disclosures specifically relating to ~~the each type of~~ entity combination transaction or other event will need to be determined.

Key Issue #3(a)5—Should pro forma comparative financial information be permitted and/or required~~the comparative amounts be restated?~~

- 3.97 A key issue will be to determine whether ~~or not~~ the comparative amounts in recipient’s or acquirer’s consolidated and separate financial statements should also include ~~be restated~~ pro forma information as if the acquired entity had been acquired as at the beginning of the most recent comparative period~~the recipient’s consolidated and separate financial statements should be restated.~~

4. Describe the Implications for any Specific Persons or Groups

(a) Relationship to IASB

- 4.1 ~~One aspect of t~~This project ~~is that it~~ will ~~encompass~~ ~~entity~~ combinations of entities under common control. The IASB has identified an item “Common Control Transactions” on the Research and Other Projects section of its Work Plan. The project’s scope is to explore the definition of common control and the methods of accounting for business combinations under common control—in the acquirer’s consolidated and separate financial statements. The project will also consider the accounting for demergers, such as the spin-off of a subsidiary or business. This project is currently deferred and is unlikely to be placed on the active agenda for some time.

(b) Relationship to Other Standards, Projects in Process or Planned

- 4.2 Dependent upon the output of this project, there may be implications for other IPSASs. The following list describes what those implications might be for There are several IPSASs such as IPSAS 23, “Revenue from Non-exchange Transactions (Taxes and Transfers)” and IPSASs 28–30 on financial instruments, which may require subsequent amendments, as follows. The following identifies some of those IPSASs. As the project develops, potential implications for other IPSASs may also be identified for future review. At this stage (October 2010), there are no IFRIC Interpretations that are relevant to this project. The actions of IFRIC will be monitored as the project develops.

Consequential Amendments

- 4.3 The following IPSASs are likely to be directly affected by this project and may require amendment as a consequence – to be monitored as the project develops.

i. IPSAS 21, “Impairment of Non-Cash-Generating Assets”

- 4.4 IPSAS 21, “Impairment of Non-Cash-Generating Assets” is adapted from IAS 36, “Impairment of Assets.” Involvement in an entity combination may need to be identified as a trigger for an impairment test where the measurement of the net assets received and net liabilities assumed are at carrying amount.

ii. IPSAS 26, “Impairment of Cash-Generating Assets”

- 4.53 IPSAS 26, “Impairment of Cash-Generating Assets” does not include goodwill or cash-generating units in its scope. This Standard is also adapted from IAS 36, “Impairment of Assets,” IAS 36 includes which contains extensive requirements and guidance on the impairment of goodwill and cash-generating units. When IPSAS 26 was developed, the IPSASB concluded that goodwill and cash-generating units should not be included in the scope of this Standard until such a time that the IPSASB has a Standard (or Standards) for entity combinations. Consequently, IPSAS 26 will need to be amended-reviewed as part of this project. Furthermore, wWhere the measurement of the assets received and liabilities

assumed in an entity combination are at carrying amount, it may be appropriate to consider this circumstance as a potential indicator of impairment~~how does an entity determine that the carrying amounts are not overstated?~~.

iii. IPSAS 31, “Intangible Assets”

- 4.64 IPSAS 31, “Intangible Assets” does not include intangible assets or goodwill acquired in a business combination in its scope. This Standard is adapted from IAS 38, “Intangible Assets,” which contains requirements and guidance on the recognition and measurement of these items. When IPSAS 31 was being developed, the IPSASB concluded that intangible assets or goodwill acquired in a business combination should not be included in the scope of this Standard until such a time that the IPSASB has a Standard for entity combinations. Consequently, IPSAS 31 will need to be ~~amended~~reviewed as part of this project.

Other IPSASs Not Directly Related to this Project but need to be Monitored

- 4.7 The following IPSASs are unlikely to be directly affected as a consequence of this project. However, there may be some overlap and interaction, and gives an opportunity to process needed and, arguably, related changes – to be monitored as the project develops.

iv. IPSAS 6, “Consolidated and Separate Financial Statements”

- 4.85 IPSAS 6, “Consolidated and Separate Financial Statements” requires that a controlled entity be excluded from the consolidated financial statements where there is evidence that (a) control is intended to be temporary because the controlled entity is acquired and held exclusively with a view to its disposal within twelve months from acquisition and (b) management is actively seeking a buyer. ~~While this is not directly specifying the accounting treatment of an entity combination, there is a requirement for this controlled entity to be excluded from full consolidation in the recipient’s consolidated financial statements.~~

- 4.96 IPSAS 6 is based upon the December 2003 version of IAS 27, “Consolidated and Separate Financial Statements.” The IASB removed this exemption from IAS 27 with the issue of IFRS 5, “Non-current Assets Held for Sale and Discontinued Operations” in March 2004. It is unclear as to whether or not there is a public sector specific reason for retention of the exemption in IPSAS 6. ~~Thus, this project will address whether or not the exemption from full consolidation is appropriate.~~In addition, the IASB is currently revising IAS 27. It is expected that a revised Standard will be issued in Quarter 4, 2010. The IPSASB’s draft Work Plan for 2010–2012 potentially includes the revision of IPSAS 6 as part of the entity combinations project. The IASB project will need to be monitored for interaction with this project.

- 4.107 IPSAS 6 includes guidance on how to account for controlled entities in the consolidated and separate financial statements of a controlling entity. IPSAS 6 may also require amendment as the decisions made regarding each type of entity combinations, i.e., the initial recognition and measurement of a controlled entity

in the recipient's consolidated and separate financial statements, may affect the subsequent accounting of this controlled entity. For example, it may be appropriate to reconsider whether GBEs should continue to be fully consolidated into the economic entity's consolidated financial statements.

v. IPSAS 7, "Investments in Associates"

4.11 IPSAS 7, "Investments in Associates" is based upon IAS 28, "Investments in Associates" (2003). IAS 28 has been subsequently amended. This project may be the appropriate timing to revise IPSAS 7, at the same time as IPSAS 6 and IPSAS 8 are being revised. Note that the IPSASB's draft Work Plan for 2010–2012 potentially includes the revision of IPSAS 7 as part of the entity combinations project.

vi. IPSAS 8, "Interests in Joint Ventures"

4.128 IPSAS 8, "Interests in Joint Ventures" is based upon IAS 31, "Interests in Joint Ventures." Although this topic is not directly related to how to account for an entity combination, the IASB is currently revising IAS 31 and it is expected that an amended Standard will be issued in Quarter 43, 2010. It may be appropriate to revise IPSAS 8 at the same time as IPSAS 6 and IPSAS 7, as they both deal with interests in other entities, as part of this project. Note that the IPSASB's draft Work Plan for 2010–2012 potentially includes the revision of IPSAS 8 as part of the entity combinations project. The IASB project will need to be monitored for interaction with this project.

(c) Other—Government Finance Statistics

4.139 One aspect of the IPSASB's strategic theme of undertaking public sector specific projects is to consider convergence with the statistical basis of accounting where appropriate. This project will explore how entity combinations are accounted for under the statistical basis and whether ~~or not~~ there are opportunities for the accounting treatment to be similar to that used for the statistical basis of accounting. In addition, the project may also consider disclosures to assist users in reconciling differing requirements. This may result in a review of IPSAS 22, "Disclosure of Financial Information about the General Government Sector."

5. Development Process, Project Timetable and Project Output

(a) Development Process

5.1 The development of outputs will be subject to the IPSASB's formal due process. The issuance of documents for public comment will be subject to the usual IPSASB voting rules. As the project progresses, regular assessments will be made to confirm the proposed path in the project timetable remains the most appropriate.

(b) **Project timetable**

<u>Major Project Milestones</u>	<u>Expected Completion</u>
<u>Present revised Project Brief</u>	<u>November 2010</u>
<u>Discussion of issues and development of a Consultation Paper (CP) (January–September 2011)</u>	
<u>Approve CP (6 month comment period)</u>	<u>September 2011</u>
<u>Review of responses to CP and development of an Exposure Draft or Drafts (April 2012–March 2013)</u>	
<u>Approve ED/EDs (4 month comment period)</u>	<u>March 2013</u>
<u>Review of responses to ED and development of a IPSAS/IPSASs</u>	
<u>Approve Final IPSAS /IPSASs</u>	<u>2014</u>

5.2 The review of IPSASs 6–8 will commence when the review of responses to the CP has been completed and will be undertaken in the same time frame as the development of the entity combinations ED/EDs and issue of an IPSAS(s).

<u>Major Project Milestones</u>	<u>Expected Completion</u>
<u>Present revised Project Brief</u>	<u>November 2010</u>
<u>Discussion of Issues</u>	<u>November 2010</u>
<u>Further discussion of Issues</u>	<u>March 2011</u>
<u>Review Draft Consultation Paper (CP)</u>	<u>June 2011</u>
<u>Approve CP (6 month comment period)</u>	<u>September 2011</u>
<u>Initial analysis of responses to CP</u>	<u>June 2012</u>
<u>Discussion of Issues</u>	<u>September 2012</u>
<u>Further discussion of Issues</u>	<u>December 2012</u>
<u>Review draft Exposure Draft (ED)</u>	<u>March 2013</u>
<u>Approve ED (4 month comment period)</u>	<u>June 2013</u>
<u>Analysis of Responses to ED</u>	<u>December 2013</u>
<u>Discussion of Issues</u>	<u>March 2014</u>
<u>Further discussion of Issues</u>	<u>June 2014</u>
<u>Review draft IPSAS</u>	<u>September 2014</u>
<u>Approve Final IPSAS</u>	<u>December 2014</u>

(c) **Project output**

5.3 The initial output will be a Consultation Paper. The ultimate output will be an IPSAS or IPSASs Standard or Standards.

6. Resources Required

(a) **Task Force/Subcommittee**

6.1 A Task Force may be required to assist in providing a broad spectrum of the types of entity combinations that are undertaken.

(b) Staff

- 6.2 It is envisaged that 0.5 Full Time Equivalent (FTE) will be required to resource the project.

(c) Factors that might add to complexity and length

- 6.3 Factors that might add to the complexity and length of the project include:
- 6.3.1 The wide range of entity combinations undertaken in the public sector.
 - 6.3.2 The relative lack of existing guidance on entity combinations in the public sector.
 - 6.3.3 The interaction between this project and IPSAS 6.
 - [6.3.4 The interaction between this project and the development of the Conceptual Framework.](#)

7. Important Sources of Information that Address the Matter being Proposed

- 7.1 Potential sources of information regarding entity combinations include:
- 7.1.1 IFRS 3, “Business Combinations.”
 - 7.1.2 The IASB’s currently deferred project on Common Control Transactions.
 - 7.1.3 National Standard Setters guidance on entity combinations.
 - 7.1.4 The Government Finance Statistics Manual (2001).
 - [7.1.5 The System of National Accounts \(SNA\) 2008.](#)

ENTITY COMBINATIONS COMMENTS ON REVISED PROJECT BRIEF

Purpose:

This paper presents Members and TAs comments on the revised Project Brief for Entity Combinations.

List of Respondents:

Response #	Respondent Name
1	Frans van Schaik
2	Shelia Fraser
3	Erna Swart
4	Stefan Berger
5	Ron Salole
6	Joanne Scott

#	RESPONDENT NAME	COMMENTS	PROPOSED RESPONSE
1	Frans van Schaik	Agree, thank you.	Noted.
2	Shelia Fraser	I think [the Project Brief] captures our discussion in Vienna and covers the main issues that need to be addressed in this project. A couple of comments: - In paragraph 2.1, I would add ‘or other policy objectives’ to the end of the first sentence. Not all decisions are made solely on a financial basis.	The phrase “or other policy objectives” has been added to the end of the first sentence of paragraph 2.1.
2	Shelia Fraser	- A big challenge I think you will have will be terminology. Even in this brief, the terms are many and can be confusing; e.g., recipient, acquirer, transferee, etc. I would identify this as a separate issue.	Staff is uncertain as to whether terminology can be addressed as a separate key issue and so has modified Key Issue 1 to include discussion on terminology (in paragraph 3.3).
2	Shelia Fraser	- Another aspect that will need to be discussed is the fact that, for many public sector entities (governments), the notion of ‘owner’ is not obvious - who are the ‘owners’ of a municipality and who ‘owns’ a merged one. I assume this would be part of your discussion of ‘common control’.	Key Issue 2(c) has been inserted to acknowledge that a discussion of the term “owner” is likely to be a key issue (in paragraph 3.7).
3	Erna Swart	Thank you for the opportunity to review the project brief.	Noted.
3	Erna Swart	The reason for the change in name from “business” to “entity” is that the term “business” implies a profit objective, while the public sector renders services. This is not captured by the phrase “activities for community or social benefit”.	Paragraph 1.3 has been deleted. Paragraph 1.2 has been amended.
3	Erna Swart	The statement made in paragraph 1.3 that most combinations will involve non-cash generating activities is also irrelevant, as IFRS 3 does not require that a distinction be made between the acquisition of cash and non-cash generating businesses.	Paragraph 1.3 has been deleted.
3	Erna Swart	The March [2004] definition of a business combination in paragraph 1.4 is irrelevant, because this project is supposed to consider the latest international standard. The current definition of a business combination is more relevant, as the issue of whether or not an acquirer can be identified, is key to the public sector issue arising on convergence that, where two or more local government entities are merged, no acquirer can be identified. This is the case where local government entities are not controlled by national or state governments. The definition in the	Paragraph 1.4 has been deleted.

#	RESPONDENT NAME	COMMENTS	PROPOSED RESPONSE
		<p>latest IFRS 3 is “a transaction or event in which an acquirer obtains control of one or more businesses” should be used as the working definition in paragraph 1.6.</p> <p>Accordingly, we agree that this project should address the wider issue, but we would appreciate the correct reasons being identified for the changed scope.</p>	
3	Erna Swart	<p><i>Project rationale and objectives</i></p> <p>In paragraph 2.1 the phrase “a union of districts or regions, an amalgamation or an administrative arrangement” is used to describe entity combinations. We have commented on numerous occasions that this introduce jurisdictional issues that are not understood in an international context. We do not need this phrase if an entity combination is defined as</p> <p>Either (a) a transaction or event in which an acquirer obtains control of one or more entities, or (b) a transaction or event in which one or more entities are brought together into a single entity.</p> <p>In my opinion, we need both parts of the definition.</p>	<p>The sentence in paragraph 2.1 including the description of types of entity combinations has been deleted. However, Staff has included these examples (in paragraph 3.1) of terms used to describe these types of entity combinations in some jurisdictions.</p> <p>New paragraph 1.3 has been amended to clarify that the working definition encompasses both (a) and (b) of your description of an entity combination.</p>
3	Erna Swart	<p>The examples listed in paragraph 2.1 exclude transactions between entities under common control. Transactions between entities under common control are the most prevalent in the public sector, but are specifically excluded from the scope of IFRS 3. Unless this project addresses transactions undertaken by entities under common control, it will not be a worthwhile exercise.</p>	<p>Staff had not intended this paragraph to be read to exclude transactions between entities under common control and has amended the paragraph accordingly. See also paragraph 3.1.</p>
3	Erna Swart	<p>Part (a) of the definition requires an entity to identify an acquirer. As this does not require a purchase price to have been paid both non-exchange and exchange transactions should be included in the scope of the project.</p>	<p>The working definition of an entity combination is intended to encompass exchange transactions and non-exchange transactions. Reference to this aspect of an entity combination is included in paragraph 3.1 and Key Issue 2(b) (was KI #4), but it can be included here too, if necessary.</p>
3	Erna Swart	<p>The document refers to “net assets” (for example paragraphs 2.5.4 and 3.6). IPSASs usually refer to “net assets/equity”.</p>	<p>Staff has amended both paragraphs 2.5.4 (now 2.5.2(b)) and 3.6 to clarify that it is the “...difference arising from the net assets received or</p>

#	RESPONDENT NAME	COMMENTS	PROPOSED RESPONSE
			<p><u>net liabilities assumed</u> and the consideration transferred (if any).” Staff considers that this term is appropriate in the context because the IPSASB uses the term “net assets/equity” to refer to a particular section of the statement of financial position and the transfer of items to and from this section.</p>
3	Erna Swart	<p><i>Outline of the project</i> Paragraph 3.1 fails to refer to the entity combinations that may be a merger, as described in paragraph 2.1 and 2.1.3.</p>	<p>The term “...bringing together of entities...” in the working definition of an entity combination in the Project Brief is intended to encompass the notion of a merger. Paragraph 3.1 has been amended accordingly.</p>
3	Erna Swart	<p>We acknowledge that IFRS 3 does not provide guidance to the acquiree as existing guidance in the form of IFRS 5 <i>Non-current Assets Held for Sale and Discontinued Operations</i> provides such guidance. In the absence of a public sector equivalent, consideration should be given to provide some guidance to the acquiree in an entity combination as IFRS 5 only addresses private sector circumstances.</p>	<p>As this project develops, it will assess potential consequential issues, such as whether or not the IPSASB needs an equivalent standard to IFRS 5.</p>
3	Erna Swart	<p>Paragraph 3.5 refers to the “overstatement” of assets, but should likewise address and consider the “understatement” of assets.</p>	<p>This sentence has been deleted.</p>
3	Erna Swart	<p>Included in key issue #5 (paragraph 3.7) should be consideration of the appropriate accounting treatments in the entity’s own accounts and the inter-relationship with the standards on financial instruments. The issue of transaction costs should also be considered.</p>	<p>Paragraph 4.2 has been amended to include consideration of potential implications for other standards that may be identified as needing to be reviewed, such as IPSASs 28–30.</p>
3	Erna Swart	<p><i>Describe the implications for any specific persons and groups</i> It was my understanding that all the amendments made to the IASB equivalents of IPSAS 6, 7 & 8 since December 2003 would be incorporated into this project.</p>	<p>Staff agrees. The process for incorporating these changes will be to refer to the latest version of the IFRS in</p>

#	RESPONDENT NAME	COMMENTS	PROPOSED RESPONSE
		Some of those changes were made as a result of annual improvement projects and some were consequential amendments when IFRS 3 were issue and revised. My understanding is based on Agenda item 1.7 of the Vienna [June 2010] meeting.	the IASB's Bound Volume. New paragraph 4.11 relating to IPSAS 7, "Investments in Associates" has been inserted.
3	Erna Swart	The project should also consider interpretations that have been issued.	Paragraph 4.2 has been amended accordingly.
3	Erna Swart	We are somewhat surprised by the omission of IPSAS 21, Impairment of non-cash generating assets from the list of standards that may require subsequent amendment.	New paragraph 4.4 relating to IPSAS 21 has been inserted.
4	Stefan Berger	Thank you for your Project Brief to Entity Combinations. I like the document.	Noted.
4	Stefan Berger	My awareness to the failure from the previous work was because of the scope. Members felt uncomfortable of what was in or out of the scope. Given that as the weak point I would suggest you to highlight the scope in a more prominent way: - #2.5.1 (new): How should the scope look like? Definition of what is in or what is excluded. - #3.2 (b): I see the scope as a major problem and key issue, too. Therefore, Key Issue #1 - Scope	Paragraph 2.5.1 and KI #1 have been amended to refer to, and attempt to clarify, scope. Examples of types of entity combinations in the scope have been included in paragraph 3.1.
5	Ron Salole	Attached are my observations on the project brief. I did not have any substantive comments to make. I thought it could be sharper and I may have approached the beginning a little differently but have no doubt that you have good reasons for the approach you've taken.	Noted.
5	Ron Salole	Paragraph 1.4: You say it in 1.2. I might have said what is being said in 1.2 & 1.3 a little differently - but I do not disagree with the substance.	Paragraph 1.4 has been deleted. See comments from Respondent #3 above regarding this paragraph.
5	Ron Salole	Paragraph 1.5: I find myself questioning why this is here - is it gratuitous information or does it have a point? I think it is interesting but so what has it to do with this brief?	Paragraph 1.5 has been deleted.
5	Ron Salole	Paragraph 1.6: Need we say this here? An alternative to this part of the brief might be to approach it as (i) dealing with a topic needed by the sector (there is	Paragraphs 1.2, 1.3 and 2.4 have been amended to encompass these notions

#	RESPONDENT NAME	COMMENTS	PROPOSED RESPONSE
		nothing now) (ii) dealing with the issue as broadly as possible. The development of the standard will use other available standards and that the new IFRS3 is very business oriented.	and confirm that the project has a wide scope.
5	Ron Salole	Paragraph 2.1.1 and 2.1.2. [Use of the term “taking control”] implies acquisitions. And Paragraph 3.1: [I am unsure of] the use of the word recipient. But, what more importantly - are you making a judgment that we are addressing acquisitions.	Now paragraphs 1.4.1 and 1.4.2. The project encompasses, and is wider than acquisitions. Paragraphs 1.2 and 1.3 have been revised and attempt to clarify the scope. Terminology will be addressed as part of Key Issue 1.
6	Joanne Scott	Paragraph 1.5 Need to explain more clearly why using the previous version of IFRS 3. This isn't initially clear although it is explained more in paragraph 1.6. Suggest adding a sentence along the lines of "The IPSASB considered that the bringing together, rather than obtaining control, is more relevant for the public sector." Maybe also include new IFRS 3 definition for comparison.	Paragraph 1.5 has been deleted. Paragraph 1.6 (now 1.3) has been reworded to encompass the notion that the project encompasses, but is not limited to, obtaining control.
6	Joanne Scott	<p>2.5.5 Pro forma vs comparative</p> <p>"2.5.5 Should the comparative amounts be restated?"</p> <p>Under IFRSs when an entity has acquired another entity, it accounts for its acquisition from the date of acquisition. Its comparative figures (for the period prior to the acquisition) do not include any transactions or balances of the acquired entity.</p> <p>I'm therefore guessing that this question is really asking whether the acquiring entity should present figures for the pre-acquisition period, "as if" it had acquired the other entity at the beginning of the comparative period. I don't like using the term 'restatement' in this context.</p> <p>I would prefer that the term "pro forma" be used to describe the practice of revising historical financial statements to show what they would have looked like, if the combination had occurred earlier. Pro forma information may be historical or prospective.</p> <p>Preparing pro forma historical information is common in some jurisdictions but pro forma information should not be confused with restatement, which has a</p>	The paragraphs have been amended accordingly.

#	RESPONDENT NAME	COMMENTS	PROPOSED RESPONSE
		<p>different meaning in the context of IPSASs. I acknowledge that people do sometimes use the terms interchangeably but I don't think IPSASB should as it is really confusing. I think we should use the meanings in IPSASs.</p> <p>If pro forma information is permitted or required, there is a question as to whether the usual comparative information should still be required.</p> <p>Pro forma information may be included as an additional column in the historical financial statements or it may be presented as a separate section in a financial report. I can provide examples of the latter if that would be useful.</p> <p>I would rather phrase the question to read "Should pro forma comparative financial information be permitted or required? If permitted or required, what principles should be applied to its preparation and presentation and how should it be included in the financial statements?"</p> <p>These comments apply to paragraph 3.7 as well. I have suggested a possible rewording of paragraph 3.7.</p> <p>Key Issue #5—Should pro forma comparative financial information be permitted and/or requiredthe comparative amounts be restated?</p> <p>3.7 A key issue will be to determine whether or not the comparative amounts in the recipient's consolidated and separate financial statements should also include be restated pro forma information as if the acquired entity had been acquired as at the beginning of the most recent comparative period.</p>	
6	Joanne Scott	<p>Key Issue 2</p> <p>I suggest there are two issues here and that it would be helpful to deal with them separately. The two issues are:</p> <ul style="list-style-type: none"> - What should be reported in separate (parent) financial statements? - What assets and liabilities should be reported in consolidated financial statements? (i.e. those recognised under GAAP (e.g. excluding contingent liabilities) or those recognised in the transfer (e.g. possibly including a deduction for contingent liabilities). <p>A suggested reword to focus on second bullet is shown below.</p> <p>Key Issue #2—What is the appropriate accounting treatment for an entity combination on initial recognition?</p>	Paragraph 3.4 reworded as suggested.

#	RESPONDENT NAME	COMMENTS	PROPOSED RESPONSE
		<p>3.4 A key issue will be to determine the appropriate accounting treatment in the recipient's or acquirer's consolidated and separate financial statements for an entity combination. The recipient/acquirer could recognize recognition could be of existing assets and liabilities currently recognized in the financial statements of the acquiree, or all assets received and liabilities assumed in the transfer.</p>	
6	Joanne Scott	<p>IPSAS 6</p> <p>Paragraphs 4.5 and 4.6 propose reviewing the exemptions in IPSAS 6. It may be appropriate to review these exemptions but I don't think they are a necessary part of the project.</p> <p>I suggest that this project brief present two options:</p> <p>(i) whether we should produce a package of standards, including a revised IPSAS 6; or</p> <p>(ii) whether we should produce a single standard.</p> <p>It is probably too early to make this decision now. A good time to seek the IPSASB's views on these options would be after the revised IAS 27 is finalised (March 2011?). An issue paper could describe the changes to that standard, the impact generally, the impact on the combinations standard and seek guidance on which option (package of standards or single standard) the IPSASB prefers.</p>	<p>The IPSASB agreed to include the review of IPSAS 6 (and IPSASs 7 and 8) as a part of this project in its discussion of the 2010–2012 Work Plan at its April 2010 meeting.</p>
6	Joanne Scott	<p>GFS</p> <p>In addition to looking at opportunities for similar accounting treatment, suggest the project also considers disclosures to assist users in reconciling differing requirements.</p>	<p>Amended paragraph 4.13 to reflect this point.</p>
6	Joanne Scott	<p>Edits</p> <p>3.6 – replace reference to "income statement" with IPSASs terminology</p> <p>4.3 Maybe say that IPSAS 26 will need to be reviewed rather than amended.</p> <p>4.5 IPSAS 6 ... requires <u>that</u></p>	<p>Done.</p>

ENTITY COMBINATIONS

Objective of this Issues Paper

- To **discuss and provide feedback** on aspects of Key Issue 1.

Key Issue 1: Does the Working Definition of an Entity Combination Encompass all the Types of Entity Combinations Intended by the IPSASB and Therefore Does it Establish the Intended Scope of the Project?

1. The purpose of Key Issue 1 is to ensure that there is clarity of scope for the entity combinations project. The Staff's understanding of the Board's intention is that the scope of this project will include the following:
 - (a) Combinations of entities, operations, districts or regions. Terms used to refer to these types of combinations, in some jurisdictions, include amalgamations or mergers;
 - (b) Changes in the structure of public sector entities or operations, either within an economic entity or between economic entities. These changes encompass, for example, combinations of existing departments, creation of new departments and transfer of operations between departments. In some jurisdictions, these types of combinations are referred to as reorganizations, restructures, reconstructions, realignments or administrative arrangements;
 - (c) Acquisition of entities or operations on a commercial basis; and
 - (d) Acquisition of entities or operations on a non-commercial basis.(Taken from paragraphs 3.1.1–3.1.4 of the revised Project Brief.)
2. Further, the Staff's understanding of the Board's intention is that the scope of this project will exclude the following:
 - (a) The formation of a joint venture; and
 - (b) The transfer of an asset or a group of assets that do not constitute an entity or an operation.(Taken from paragraphs 3.2.1–3.1.2 of the revised Project Brief.)
3. The draft revised Project Brief (Agenda Paper 10.1) sets out that the following issues will be covered in Key Issue 1 (paragraph 3.3):
 - (a) Explain the terminology used to describe an entity combination and the working definition of an entity combination;
 - (b) Explore whether or not the transactions or events listed in paragraph 1 meet the working definition; and
 - (c) Consider other terms that may need to be defined.

4. This Issues Paper will cover the first two points in paragraph 3. The third point will be considered at the next IPSASB meeting.

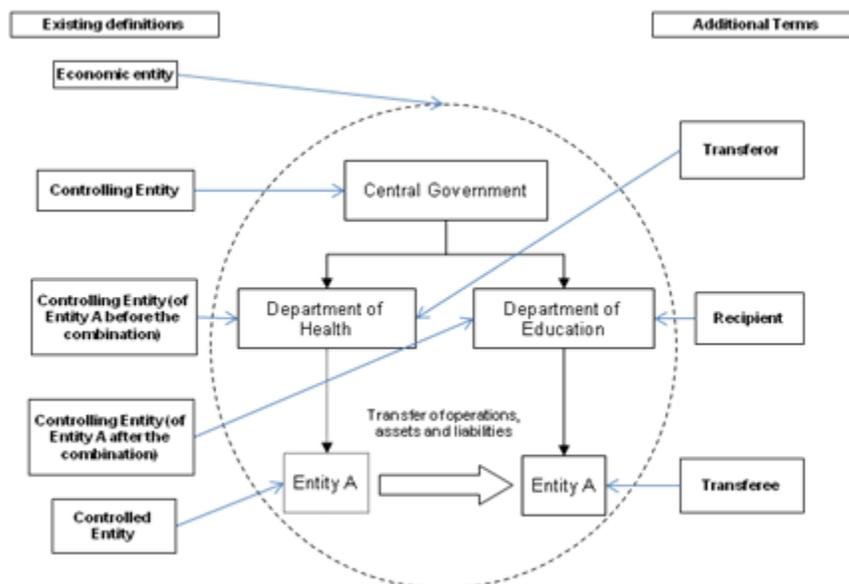
Terminology

5. The IPSASB has defined terms that are relevant to entity combinations as set out below.

Term	Definition	Location
controlled entity	An entity, including an unincorporated entity such as a partnership, which is under the control of another entity (known as the controlling entity).	6.7
controlling entity	An entity that has one or more controlled entities.	6.7
economic entity	A group of entities comprising a controlling entity and one or more controlled entities.	1.7

6. Phase 1 of the Conceptual Framework project is proposing to change some of the terms used. For example, “economic entity” may become “group reporting entity.” The interaction between this project and the Conceptual Framework project will be monitored as both projects are progressed. Where there are consequences for the entity combinations project, then this issue will be included in future agenda papers.
7. To describe an entity combination, Staff has used certain terms so that it is easy to identify the parties involved an entity combination. Diagram A below includes the existing defined terms in bold on the left-hand side. The additional terms used are shown in bold on the right-hand side.

Diagram A: Terminology



8. Using Diagram A as an example, this economic entity comprises, the controlling entity, Central Government, two lower-level controlling entities, the Department of Health and the Department of Education. These departments are also controlled entities of the Central government. Entity A is a controlled entity of the Department of Health before the entity combination is undertaken. The entity combination transfers Entity A from the Department of Health (the transferor) to the Department of Education (the recipient). Entity A is the transferee.
9. A description of the additional terms used is below.

A recipient is the entity that obtains control of the transferee.
A transferee is the entity or operation that the recipient obtains control of in an entity combination.
A transferor is the entity that transfers one or more of its controlled entities or operations to another entity.

10. The terms “recipient” and “transferor” are used in IPSAS 23, “Revenue from Non-exchange Transactions (Taxes and Transfers).” IPSAS 23 sets out the requirements for the financial reporting of revenue arising from non-exchange transactions, other than non-exchange transactions that give rise to an entity combination. The revenue of many public sector entities is derived from non-exchange transactions such as transfers. Transfers are inflows of future economic benefits or service potential from non-exchange transactions, other than taxes. The entity that transfers assets to another entity is the transferor and the entity that obtains the transfer is the recipient. Staff considers that the use of these terms for the entity combinations project is consistent with the way the terms are used in IPSAS 23.

Question 1: Does the IPSASB consider that the terms recipient, transferee and transferor need to be defined?
--

Definition of an Entity Combination

Working Definition of an Entity Combination

11. The Project Brief (paragraph 1.3) includes a working definition of an entity combination:
- “The bringing together of separate entities or operations into one reporting entity.”**
12. This Issues Paper explains the key components of that working definition and “tests” those components and the definition to determine whether or not it is appropriate.

13. For ease of reference, the IASB’s definition of a business combination and associated terms are included in Appendix B.

Explanation of the Term “Bringing Together”

14. In the context of the working definition, bringing together means either:
- (a) An existing or newly established entity taking control of one or more entities;
 - (b) An existing or newly established entity taking control of the operations of one or more entities. See below for an explanation of the term “operation”; or
 - (c) Two or more entities or operations combining.
- (Taken from paragraphs 1.4.1–1.4.3 of the revised Project Brief.)

Explanation of the Term “Separate Entity”

15. For the purposes of an entity combination, “separate entity” means that the entities or operations being combined are not controlled by the same immediate controlling entity before the entity combination transaction or other event takes place. The inclusion of “immediate” in the description is to clarify which controlling entity is to be considered where there is an economic entity comprising several levels of entity. This means that an entity combination can be undertaken within an economic entity, i.e., involve entities under common control.

Explanation of the Term “Operation”

16. For the purposes of an entity combination, an “operation” means “an integrated set of activities, related assets and liabilities, that is conducted and managed for the purpose of achieving an entity’s objectives or a particular subset of objectives, either by directly providing services or providing service potential to support their provision.”
17. This means that the receipt of an asset or a group of assets which do not constitute an operation do not meet the working definition of an entity combination. Guidance on the accounting treatment of the receipt of an asset or a group of assets is within the scope of other IPSASs.

Consideration

18. The working definition does not include a reference to the transfer of consideration. This is because the scope of this project includes both exchange and non-exchange transactions and an entity combination may or may-not include the transfer of consideration.

Summary of Conditions Required to Meet the Working Definition of an Entity Combination

19. A transaction or other event meets the working definition of an entity combination occurs where the following two conditions are met:
- (a) That, before joining together or combining into one reporting entity, the entities or operations involved were previously separate entities; and
 - (b) That an entities and/or operations are involved in the combination rather than a group of assets and/or liabilities.

Do the Transactions or Events Listed in Paragraph 1 Meet the Working Definition?

Types of Transactions or Events

20. Paragraph 1 lists the following types of transactions or events which are intended to be in the scope of the entity combinations project.
- (a) Combinations of entities, operations, districts or regions;
 - (b) Changes in the structure of public sector entities or operations, either within an economic entity or between economic entities;
 - (c) Acquisition of entities or operations on a commercial basis; and
 - (d) Acquisition of entities or operations on a non-commercial basis.
21. For the purposes of further explanation, the descriptions in paragraph 20 of different types of entity combinations can be categorized into two fundamental types of combination as set out in Table A below.

Table A: Types of Entity Combinations

Types of Transactions or Events (paragraph 20)	Types of combination (paragraph 14)	Distinguishing Feature
(a) Combinations of entities, operations, districts or regions	<ul style="list-style-type: none"> • Two or more entities or operations combining 	<ul style="list-style-type: none"> • There is no controlling entity after the combination
(b) Changes in the structure of public sector entities or operations, either within an economic entity or between economic entities; and (c) Acquisition of entities or operations on a commercial basis; and (d) Acquisition of entities or operations on a non-commercial basis	<ul style="list-style-type: none"> • An existing or newly established entity taking control of one or more entities; or • An existing or newly established entity taking control of the operations of one or more entities 	<ul style="list-style-type: none"> • There is a controlling entity after the combination

22. The distinguishing feature of a combination where two or more entities are combining is that there is no controlling entity after the transaction or other event that comprised the entity combination. Where there is a change in the structure of

public sector entities or operations, an acquisition of an entity or operation on a commercial basis or an acquisition of an entity or operation on a non-commercial basis, a controlling entity can be identified after the transaction or other event that comprised the entity combination.

Entity Combinations Where there is no Controlling Entity after the Transaction or Other Event

23. One type of entity combination involves two or more entities or operations (transferees) combining. This type of combination is described in paragraph 19(a) above. For example, one small municipality is directed, by legislation, to combine with another larger municipality. See Appendix A, Example 1. Another example is where a new entity is created and several councils combine into that new entity. See Appendix A, Example 2. Across different jurisdictions, they may encompass what are described in some circumstances as an amalgamation, a merger, or a union of districts or regions (hereafter referred to as “amalgamation”).
24. In an amalgamation, the recipient entity is the entity that receives the entities or operations. The entities or operations that are transferred are transferees. A distinguishing feature of an amalgamation is that there is no controlling entity after the transfer.
25. An amalgamation meets the two conditions in the definition of an entity combination, because (a) before the combination, the entities or operations involved were separate and (b) it involves entities or operations (rather than a group of assets and/or liabilities).
26. Examples 1 and 2 in Appendix A illustrate amalgamations occurring within one level of government. Conceptually, it is possible for an amalgamation to be undertaken across levels of government, say a state government combines with all the local government entities within its geographical area. However, amalgamations generally occur within one level of government.

Compulsory or Voluntary

27. An amalgamation can be mandated, directed or forced onto a lower level of government by a higher level of government. For example, legislation is enacted by a Central government to reduce the number of local government entities by combining several councils into one, in order to improve services and reduce costs.
28. Whilst the compulsory nature of the amalgamation could be seen as similar in nature to the higher level of government being able to “control” the lower level of government, the determination of control for financial purposes goes back to the definition of control. IPSAS 6 “Consolidated and Separate Financial Statements” defines control as “the power to govern the financial and operating policies of another entity so as to benefit from its activities”. IPSAS 6 gives guidance on how to determine whether control for financial reporting purposes exists and

- explains that regulatory power does not constitute control for the purposes of financial reporting. Generally, each level of the public sector in a jurisdiction is autonomous and so control for financial reporting purposes does not exist.
29. Amalgamations can also be voluntary, e.g., two local government entities consider that a more effective service delivery can be obtained by combining. Usually, in this situation, the proposal will have to be approved by a higher level of government.

Transfer of consideration

30. There is no transfer of consideration for this type of entity combination.

Entity Combinations Where there is a Controlling Entity after the Transaction or Other Event

31. This category of entity combination can be described in three ways:
- (a) Changes in the structure of public sector entities or operations, either within an economic entity or between economic entities;
 - (b) Acquisition of entities or operations on a commercial basis; and
 - (c) Acquisition of entities or operations on a non-commercial basis.

Changes in the structure of public sector entities or operations, either within an economic entity or between economic entities

32. Another type of entity combination involves an existing or newly established entity (the recipient) taking control of one or more entities or operations (the transferee/s). The entity that previously controlled the transferee/s is the transferor. Across different jurisdictions, they may encompass what are described in some circumstances as a reorganization, a restructure, a reconstruction, a realignment of boundaries, funding or responsibilities, or an administrative arrangement (hereafter “reorganization”).
33. A reorganization is the act or process of reorganizing. An entity may reorganize its entities, operations, activities, assets and/or liabilities. When that reorganization involves entities or operations i.e., an integrated set of activities, related assets and liabilities, it meets one of the conditions for an entity combination. When the entities or operations involved were separate before the combination, the second condition for an entity combination is met.
34. The two economic entities can be within the same level of government, e.g., a local government council can transfer one of its controlled entities to another local government council. See Appendix A, Example 3. A reorganization can also occur between two economic entities that are different levels of government, e.g., a provincial government transfers a controlled entity to the Federal government. See Appendix A, Example 4.
35. A further aspect of a reorganization is that it can be undertaken within an economic entity or between separate economic entities. An example of a reorganization within an economic entity, i.e., under common control, is where a

provincial government undertakes a reorganization so that a controlled entity is transferred from one intermediate controlling entity to another intermediate controlling entity. See Appendix A, Example 5. Another example is where a Central government creates a new controlled entity and two of its existing controlled entities are transferred into the new entity. In this example, the Central government is both the transferor and the recipient. See Appendix A, Example 6.

Compulsory or Voluntary

36. In the same way as amalgamations, a reorganization can be mandated, directed or forced. For example, legislation is enacted by a Provincial government to transfer certain operations from one ministry to another ministry. Reorganizations can also be voluntary.

Transfer of consideration

37. In some instances an entity combination will include the transfer of consideration, e.g., the recipient entity transfers consideration to the transferor.

Acquisition of Entities or Operations on a Commercial Basis

38. A public sector entity may acquire an entity or operation on a commercial basis. A commercial basis means that the entity combination is undertaken with a view to obtaining a return on investment, either by use or sale of the asset in the same way as a business entity has a commercial objective. For example, a local government entity acquires a for-profit private sector entity with the intention of continuing to run it as a profitable business. See Appendix A, Example 7.

Compulsory or Voluntary

39. An acquisition of entities or operations on a commercial basis is voluntary.

Transfer of consideration

40. Because the entity combination is undertaken on a commercial basis, it is likely that it will include the transfer of consideration, i.e., the recipient entity transfers consideration to the transferor.

Acquisition of Entities or Operations on a Non-commercial Basis

41. A public sector entity may acquire an entity or operation on a non-commercial basis. A non-commercial basis means that the entity combination is undertaken for reasons other than obtaining a return on investment. There can be a number of different reasons. For example, a provincial government becomes the controlling entity of a hospital that was formerly owned by a private sector not-for-profit entity in order to maintain those hospital services. See Appendix A, Example 8. Another example is where a federal government becomes the controlling entity of a commercial business which was formerly a listed company, i.e. a for-profit private sector entity. The reason for undertaking this transaction was to ensure the smooth running of the economy rather than see the entity go into liquidation.

- See Appendix A, Example 9. Another example is where a federal government obtains a for-profit private sector entity to ensure continuity of the maintenance of its navy. See Appendix A, Example 10.
42. Other Issues Papers will examine whether reorganizations and acquisitions are in substance different from one another and the potential consequences of this on the accounting treatment.

Question 2:

Does the IPSASB agree that the above transactions and other events are to be included within the scope of the project?

Question 3:

Does the IPSASB agree that the working definition of an entity combination is appropriate at this early stage of the project?

Next Steps

43. A revised paper on Key Issue 1 will be presented at the next IPSASB meeting in March 2011.

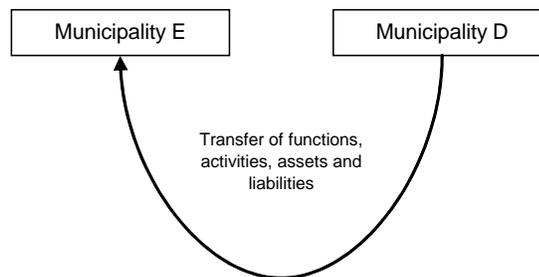
Appendix A

Examples of Different Types of Entity Combinations

Entity Combinations where there is no Controlling Entity after the Transaction or Other Event

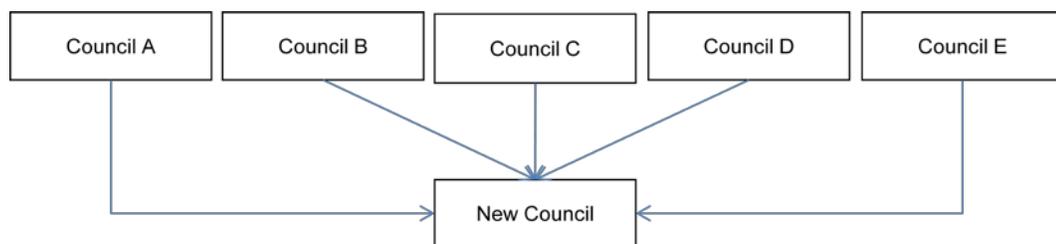
Example 1: Transferring an Operation from one Entity to another Entity

1. A Federal government creates legislation which mandates that the activities, assets and liabilities of Municipality D are annexed into the much larger Municipality E, (a neighboring municipality), without the consent of either of the municipalities or their inhabitants. The Federal government’s policy reason for taking such action is to create economies of scale by ensuring that each municipality within its jurisdiction is of a certain size. In this jurisdiction, the local government is not controlled by the Federal government for financial reporting purposes. Thus, this combination is not under common control. Municipality D is the transferee and Municipality E is the recipient.



Example 2: Creating a New Entity and Transferring Several Entities to it

2. A Central government creates legislation which mandates that the five local government entities (Councils A, B, C, D, and E) in one geographical area (covering a city) must transfer all operations, assets and liabilities into a newly created local government entity, New Council, which is responsible for the entire geographical area. In this jurisdiction, the local government is not controlled by the Central government for financial reporting purposes. Thus, this combination is not under common control. Councils A–E are the transferees and New Council is the recipient.

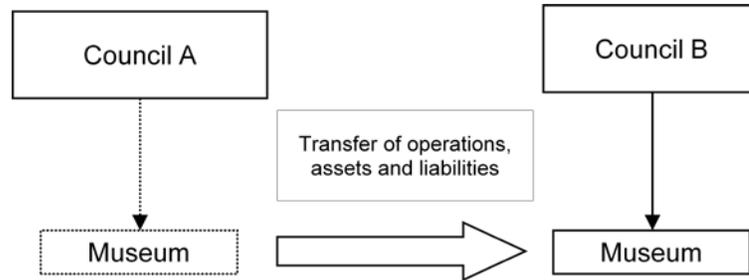


Entity Combinations Where there is a Controlling Entity after the Transaction or Other Event

Reorganizations

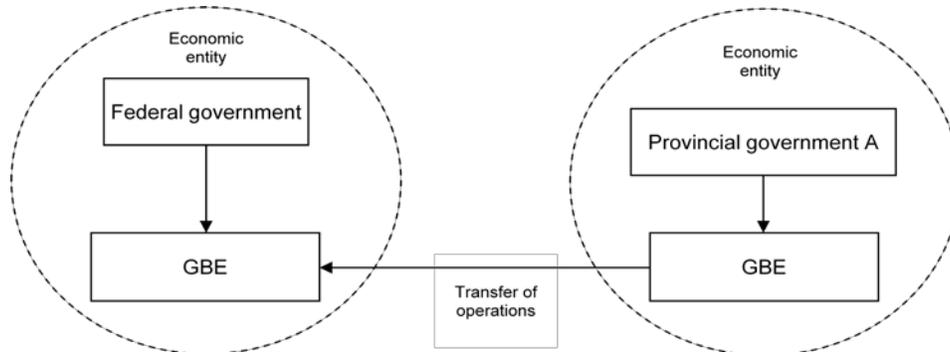
Example 3: Transferring an Entity from One Economic Entity to another Economic Entity within the Same Level of Government

3. Council A transfers an operation, e.g., a Museum, to Council B. Both Council A (the transferor) and Council B (the recipient) are separate economic entities.



Example 4: Transferring an Entity from One Economic Entity to another Economic Entity between Levels of Government

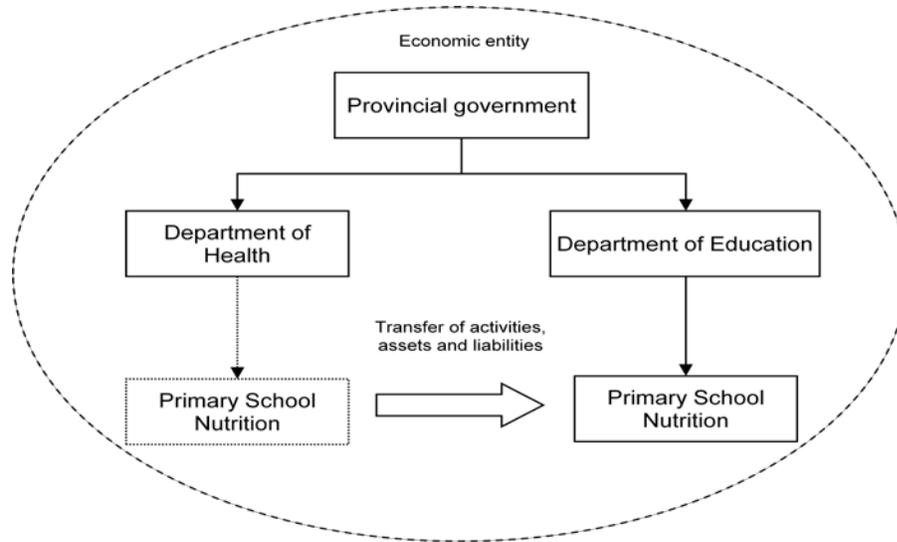
4. A Provincial government transfers a GBE to the Federal government.



5. Note that a GBE is a public sector entity with a commercial objective. The GBE uses IFRSs to prepare its financial statements. At the consolidated level, an economic entity uses IPSASs to prepare its financial statements.

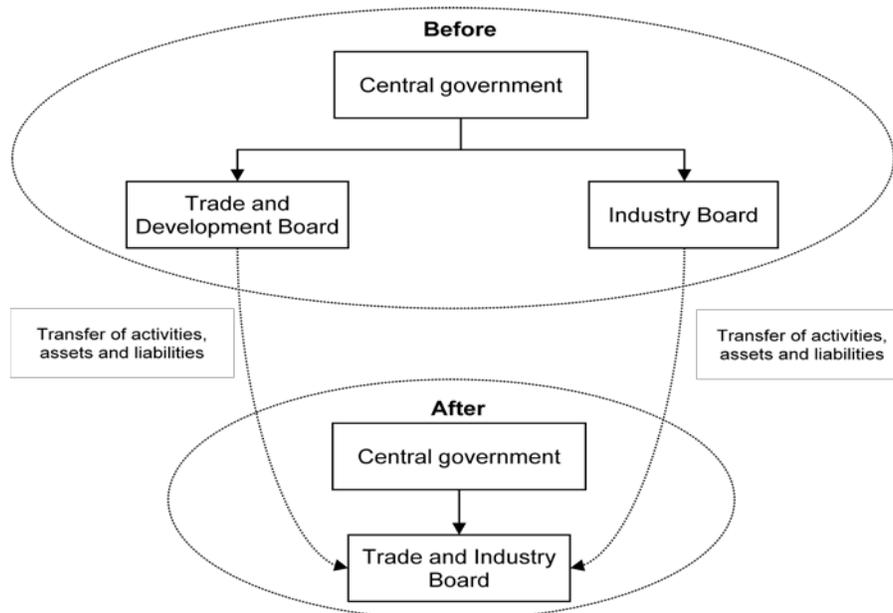
Example 5: Transferring an Entity from one Reporting Entity to another Reporting Entity

6. A Provincial government restructures by transferring its Primary School Nutrition Program from the Department of Health to the Department of Education. The ultimate controlling entity is the Provincial government and it is the economic entity. The Department of Health (the transferor) and the Department of Education (the recipient) are reporting entities.



Example 6: Transferring Two Entities in One Economic Entity to a New Entity

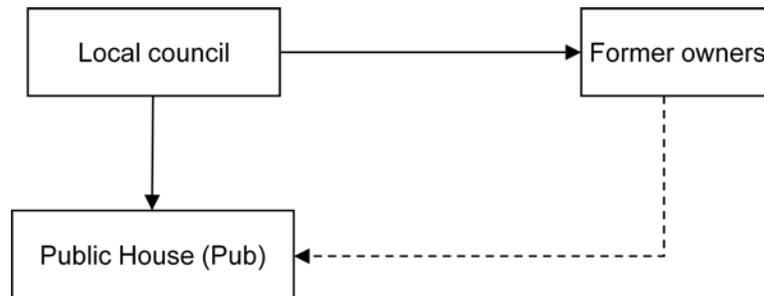
7. A Central government restructures by closing down the Trade and Development Board and the Industry Board, both of which are separate government entities and transferring the operations, assets and liabilities to a newly created government entity, the Trade and Industry Board. The Trade and Development Board and the Industry Board are the transferors and the Trade and Industry Board is the recipient.



Acquisition on a Commercial Basis

Example 7: A For-Profit Private Sector Entity is purchased by a Public Sector Entity

8. A local Public House (Pub) is a successful for-profit private sector entity. The local council buys it so that the profits can be used help pay for the services it provides to the community and thereby keep the rates (local taxes) from increasing, i.e., the Pub will be run as a cash-generating unit.

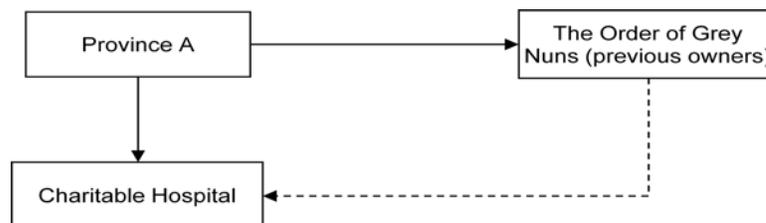


9. The Local council is the recipient, the Pub is the transferee and the former owners are the transferor.

Acquisition on a Non-commercial Basis

Example 8: A Not-for-Profit Private Sector Entity is transferred to a Public Sector Entity

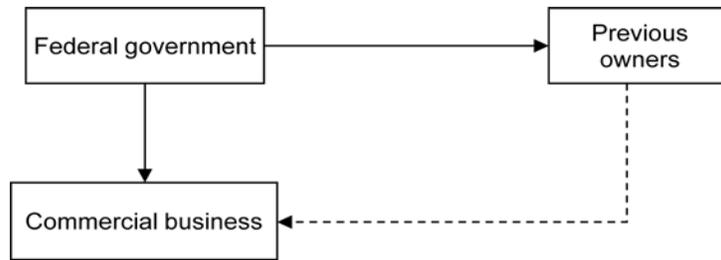
10. A Provincial government becomes the controlling entity of an operation from a private sector not-for-profit entity. A possible reason for undertaking this transaction is that Province A wishes to maintain the hospital's services to the public.



11. Province A is the recipient, The Order of Grey Nuns is the previous owner and the hospital is the transferee.

Example 9: A For-Profit Private Sector Entity is transferred to a Public Sector Entity

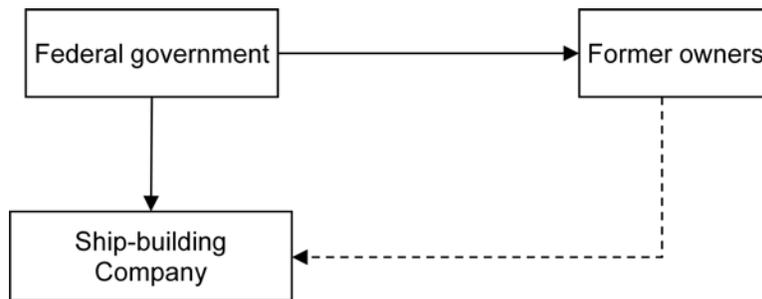
12. A retail bank which was previously owned by entities in the private sector is transferred to a Federal government. The reason for undertaking this transaction is that the current trading conditions are unfavorable and the retail bank is in extreme financial difficulty. The government makes a policy decision to recapitalize the bank rather than allowing it to be put into statutory liquidation.



13. The Federal government is the recipient and the retail bank (commercial business) is the transferee.

Example 10: A For-Profit Private Sector Entity is purchased by a Public Sector Entity

14. A ship-building company is a successful for-profit private sector entity. It is the subject of a hostile foreign takeover. The Federal government steps in, as this is a matter of national security, and buys the ship-building company to protect access to the maintenance of the ships in its navy. The Federal government intends to run the ship-building company as a non-cash-generating unit.



15. The Federal government is the recipient, the ship-building company is the transferee and the former owners are the transferor.

Appendix B

Business Combinations in the For-Profit Private Sector

1. The IASB sets accounting standards for for-profit private sector entities. Its standard on this topic is IFRS 3, “Business Combinations,” which was issued in January 2008 and defines a business combination as follows:

“A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as ‘true mergers’ or ‘mergers of equals’ are also business combinations as that term is used in the IFRS.”

2. Associated definitions are as follows:

A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses.
An acquirer is the entity that obtains control of the acquiree.
An acquiree is the business or businesses that the acquirer obtains control of in a business combination.
A former owner is the entity that sells one or more of its controlled entities to another entity.

3. For users of IFRSs, this means that a business combination is always considered to be an acquisition, where an acquirer gains control of an acquiree. The IASB considered that “true mergers” or “mergers of equals” in which “none of the combining entities obtains control of the others are so rare as to be virtually non-existent.”¹ To address the rare circumstance where identifying an acquirer is difficult, IFRS 3 includes guidance on how to identify the acquirer in a business combination.

¹ IFRS 3, Basis for Conclusions, paragraph BC35.

MINUTES FROM PREVIOUS MEETINGS—ENTITY COMBINATIONS

- June 2010
- April 2010
- December 2009
- September 2009
- February 2009
- June 2008
- March 2007

June 2010

4. Entity Combinations – Public Sector

Discuss Issues (Agenda Item 4)

The staff explained that the IPSASB had requested an issues paper on entity combinations in the public sector at its April 2010 meeting. The staff based its approach to the issues papers on the March 2007 Project Brief which divided the types of entity combinations into two categories, as follows.

- Entity combinations under common control; and
- Entity combinations not under common control.

Members made the following comments:

- Discussion of whether or not the local government is under the control of the central or state government needs to be expanded so that it is clear how control is determined, i.e., what are the indicators of common control?
- The discussion on entity combinations not under common control could be split to consider separately, transfers between different levels of government in a jurisdiction and transfers between government entities and public sector entities which are not government entities. Another aspect which needs to be explored is the link to GFS and its use of the category “general government sector” (GGS).
- The discussion of carrying amount as the method of combination needs to explore how reassurance can be obtained that the carrying amount is not overstated. One way of doing this could be to amend the impairment standards to add that a reorganization could be an indicator of impairment.

After a brief discussion, the IPSASB agreed that the Project Brief needs to be revised to reflect the decision at the April 2010 meeting to consider all types of entity combinations in the public sector at the same time. Once this has been done, a revised issues paper is to be presented at the November 2010 meeting.

The IPSASB also agreed that the discussion on the different methods of accounting for an entity combination should be neutral and should reflect the advantages and difficulties of each method without reaching a preliminary view.

April 2010

3. Entity combinations

Approve IPSAS (Agenda Item 3)

The IPSASB considered a draft IPSAS 32, “Entity Combinations: Acquisitions.”

Key Issue: Scope

The IPSASB discussed whether or not the scope section of proposed IPSAS 32 clearly identified which entity combinations would be within its scope. At its December 2009 meeting, the IPSASB agreed that the exchange/non-exchange split should be removed and the scope revised to exclude all non-exchange entity combinations.

A Member pointed out that the revised wording had removed the exchange/non-exchange split, but that some non-exchange entity combinations would still be within the scope of the draft Standard because it addresses bargain purchases.

The IPSASB discussed whether or not to continue with this draft Standard or to instead focus on the main issues for the public sector relating to entity combinations (i.e., mergers and reorganizations).

It was noted that the decision in June 2008 to split the project between exchange and non-exchange entity combinations so that a limited convergence project with IFRS 3, “Business Combinations” could be undertaken has been problematic—this is the third time that the Board has discussed the scope of the draft Standard and Members are still not clear which entity combinations are within its scope.

After a lengthy deliberation on the scope of the proposed IPSAS, the IPSASB agreed not to progress with the finalization of the draft Standard, but instead to focus on public sector specific entity combinations issues. The work undertaken on the draft Standard could be used at a later stage of the project.

Issues to be addressed in wider entity combinations project

The IPSASB suggested topics which should be addressed in an issues paper on entity combinations, as follows.

- How should reorganizations or mergers be accounted for?
 - Merger accounting – If merger accounting is used, should the comparative amounts be restated as if the entities had always been one entity?

- Fresh start accounting – Explanation is needed as to the effect that different measurement bases will have on the amounts reported. For example, if the measurement basis is historical cost, the change in amounts reported when assets are revalued when the reorganization or merger occurs is likely to be material, whereas if the measurement basis is replacement cost, the change in amounts reported is likely to be immaterial.
- How should combinations of entities under common control (e.g., a transfer of functions between government departments) be accounted for?
 - Should there be, or is there, an assumption, that the controlling entity is the owner?
- Is the acquisition of a private sector entity in distress in substance different from other acquisitions?
 - If so, should there be a different accounting treatment? For example, the use of equity accounting for entities in distress and the use of consolidation accounting for acquisitions.
 - Should bailouts of private sector entities be considered as a separate issue from other entity combinations?
- Accounting for goodwill – To which types of entity combinations should it apply?
- How should combinations of entities be accounted for where a cash-generating operation is acquired and the acquirer operates it as a non-cash-generating operation?
- Valuation of items in an entity combination – What is the benefit of revaluing items in an entity combination? Does the benefit outweigh the cost? Do different types of entity combinations change the answer?

The IPSASB agreed that the staff should prepare an Issues Paper on entity combinations in the public sector, to be discussed at the June 2010 meeting.

December 2009

7. Entity combinations

Approve Final Standard (Agenda Item 5)

The IPSASB considered a draft IPSAS 32, “Entity Combinations from Exchange Transactions.” Members were in agreement that the requirements of IFRS 3 were appropriate for a limited number of entity combinations in the public sector but continued to have concerns about how best to limit the scope of the proposed Standard. There were concerns that an exchange/non-exchange approach might not be appropriate because of arguments that some public sector entity combinations do result in an exchange of value.

Key Issue: Scope

The IPSASB discussed whether the scope section of proposed IPSAS 32 clearly identified which entity combinations would be within its scope. Concerns were raised regarding the following:

- The fact that the scope focuses and lists the types of entity combinations that are excluded from the Standard, rather than explaining clearly what type of entity combinations are included in the scope. The scope should be revised to make a positive statement about the types of entity combination that are included in the Standard.
- The need to highlight a characteristic for entity combinations that are excluded from the scope of the Standard that an “owner” of the acquiree cannot be identified, rather than focusing on the identity of the acquirer.
- Bargain purchases – a bargain purchase is not synonymous with a distress sale. The intent of a bargain purchase is different from a distress sale. A distress sale where a government steps in is usually due to that government’s responsibility to be the lender of last resort. A bargain purchase occurs where some sort of price is ascertained, whereas where there is no price, it is a non-exchange entity combination.
- Reference should be to “accounting for acquisitions” or something similar, rather than distinguishing between exchange and non-exchange transactions.
- Editorial suggestions were given to improve the clarity of revised paragraph 5 regarding reorganizations.

The following comments were made regarding the revised paragraph 3:

- The notion of “willing” parties is not necessary in the explanation of what an “entity combination from an exchange transaction” means.
- It does not address situations where there is a wide share ownership and this aspect should be included.
- The example of the acquisition of an airline should be changed to the acquisition of a hospital, as this example is more common.
- Split this paragraph into two paragraphs to deal with the two aspects discussed, that an entity combination within the scope of this standard arises from an arm’s length transaction and that the transaction requires the owner or controlling entity of the acquiree to be identified. If the owner or controlling entity cannot be identified then the entity combination is outside the scope of the standard.

The IPSASB directed the staff to revise the wording of the scope section of draft IPSAS 32 to include further explanation so as to make it clear which entity combinations would be within its scope. IPSAS 32 will be considered for approval at the IPSASB meeting in April 2010.

September 2009

4. Entity Combinations

Review Responses to ED 41 (Agenda Item 8)

The IPSASB considered the Staff analysis of the key issues raised from the responses to ED 41, “Entity Combinations from Exchange Transactions.”

Key Issue 1: ED 41 not relevant to the public sector

Some respondents to ED 41 questioned whether entity combinations from exchange transactions actually occur in the public sector or occur frequently enough for the proposed guidance to be relevant to public sector entities. The IPSASB discussed this issue and generally agreed that entity combinations from exchange transactions, while rare, do occur in some jurisdictions and therefore this project should continue. Several Members highlighted that it is important to communicate this point and that the IPSASB has a separate project to issue guidance on public sector specific entity combinations.

Key Issue 2: Scope limitation

Several respondents considered that the proposed scope of ED 41 is inappropriately limited and identified several reasons as to why. The IPSASB discussed whether the distinction between exchange and non-exchange entity combinations is the most appropriate distinction. Concerns were raised regarding the lack of clarity of the scope as it is currently worded in ED 41. For example, could a local government merger, where no consideration is transferred, actually be an exchange transaction, because the acquirer receives net assets and assumes responsibilities? The assumption of responsibilities could be seen as an exchange for the net assets. ED 41 does not make it clear that an exchange transaction relates to consideration being transferred and not the exchange of net assets for the assumption of responsibilities, even though the definition of a non-exchange transaction is clear that consideration transferred is financial. Thus, local government mergers would not meet the definition of an entity combination from an exchange transaction. The IPSASB generally agreed that ED 41 should be explicit that local government mergers or amalgamations are excluded from the scope of ED 41 and that the guidance should explain that local government mergers are a public sector specific issue.

Another example was discussed regarding the lack of clarity of scope in ED 41. This situation arises where there is an acquisition of an entity which is insolvent, such as where payment is made of CU1 in exchange for the assumption of net liabilities. This type of combination could be seen to be a non-exchange transaction and thus excluded from the scope of ED 41.

The IPSASB discussed several alternatives regarding how the scope of ED 41 could be clarified by excluding from the scope of ED 41 the following:

- Acquisitions that are directed or forced;
- Acquisitions that are a result of a loss of subsidies; and
- Acquisitions where there is no determined purchase price—although it was acknowledged that a lack of consideration is addressed in ED 41 as it includes in its scope mergers by contract alone.

Alternatively, the IPSASB also discussed whether or not it would be easier to add guidance in ED 41 regarding which combinations are included in the scope (i.e., what is an entity combination from an exchange transaction?). It was noted that as ED 41 is a convergence project with a private sector standard and by its very nature ED 41 will not address most entity combinations occurring in the public sector. Therefore, ED 41 should be explicit that entity combinations from exchange transactions are rare. Further, ED 41 should also be explicit that its underlying assumptions relate to:

- Entity combinations where there is a willing buyer and a willing seller;
- An acquirer can always be identified; and
- There are “owners” of the acquired entity.

The IPSASB also discussed whether or not the phrase “from an exchange transaction” at the end of “entity combination” was a useful phrase to include and whether or not the notion of an exchange transaction was already implicitly embedded in ED 41, as it is based on a private sector standard. Additionally, a suggestion was made that the scope of ED 41 could be made clearer by returning to the original term “business combination” instead of using “entity combination.”

The IPSASB directed the Staff to revise the wording of the scope section of ED 41 to include further explanation to make it clear which entity combinations would be within its scope.

Additionally, a respondent raised a concern that paragraph 5 of ED 41 refers to IPSAS 3 and the hierarchy for guidance on non-exchange entity combinations, but this reference is not helpful because there is currently no international or national guidance on how to account for entity combinations from non-exchange transactions. The IPSASB agreed that the reference to IPSAS 3 and the hierarchy should be removed from ED 41.

Key Issue 3: Need for a project on goodwill

Several respondents considered that the paragraphs relating to the treatment of goodwill arising from the acquisition of a non-cash-generating operation should be in the text of the Standard itself and not in the Application Guidance. The IPSASB agreed with this suggestion.

A respondent also suggested that a separate project be initiated to review the accounting treatment for goodwill in public sector entities. The IPSASB agreed that this issue should be added to the list of potential projects to be considered as the IPSASB’s 2010-2012

Strategic Plan is developed. Project priorities will be assessed at the next IPSASB meeting in December 2009.

Key Issue 4: Changes to IAS 27 not reflected in IPSAS 6

A respondent raised a concern regarding the fact that amendments made to IAS 27, “Consolidated and Separate Financial Statements” at the same time as the revision to IFRS 3, “Business Combinations” in January 2008, have not been reflected in IPSAS 6, “Consolidated and Separate Financial Statements,” either as a consequential amendment to ED 41 or as a separate update of IPSAS 6. The amendments to IAS 27 provide additional guidance which is not currently reflected in IPSASs. The IPSASB generally agreed that the amendments to IAS 27 need to be considered, and that this should be a separate project to ED 41. The IPSASB agreed that this issue should also be added to the list of potential projects to be considered as the IPSASB’s 2010-2012 Strategic Plan is developed.

February 2009

4. Entity Combinations (IFRS 3 Convergence and Non-Exchange Entity Combinations)

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 "acquire," 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.

[June 2008](#)

5 Entity Combinations

Staff provided a brief background noting that in Accra the Board had agreed the need for this project to commence in 2008 with the general view that IFRS 3 could be convergent for the public sector.

Staff gratefully acknowledged the support provided by the staff of the South African member in the preparation of the papers as well as those Board members who were able to provide, since the Accra meeting, examples of entity combinations in their jurisdictions.

Members began by discussing the view that, overall, for those restructurings which fall outside of IFRS 3 (particularly where under common control), public sector restructurings should occur with no re-measurement of the underlying assets and liabilities impacted i.e., carrying values should be used.

Even if the restructuring occurred between entities where the existence of common control was transitory in nature (eg: forced amalgamation of municipalities by a higher level of government), it was noted that such restructurings should also apply carrying values. In such circumstances there was arguably a common control which existed beyond that of a transitory nature – notably the collective common control of the general citizenry by the higher level of government.

To use a value other than carrying value would have the potential to compromise comparability between the current and future periods, consistency, accountability and impose a cost to perform the re-measurement which would not at least equal the benefits.

The broad application of carrying values to public sector restructurings outside of IFRS 3 was generally supported by numerous members. An additional comment was made that from, for example, the perspective of amalgamating/annexing of municipalities, to re-measure assets and liabilities would subsequently impact costs of services to citizens despite the substance of the restructured entities remaining the same.

Members considered that despite general agreement with the opening discussion, it was still necessary to have a fulsome discussion on the underlying issues.

Grouping of Restructurings

Staff noted that in keeping with the scope of IFRS 3, it was being proposed to have the project consider four categories of restructurings divided into two groups:

Group 1 – Entity Combinations – public sector version of IFRS 3 covering restructurings:

- not under common control – exchange transactions; and

Group 2 – Transfer of Functions – separate IPSAS project covering restructurings:

- not under common control – non-exchange transaction;
- under common control – exchange transaction; and
- under common control – non-exchange transaction.

Comment was made as to the need for a project for any of the group 2 restructurings as the resulting accounting should all be at carrying value. The lack of complexity did not warrant a specific project.

Others considered that the absence of international guidance for at least common control restructurings, which were very prevalent in the public sector, necessitated the need for a public sector project. The IPSASB generally shared this view though there was discussion as to how the four categories should be grouped. Some considered that the groupings could be more user-friendly.

A suggestion was made to organize according to whether or not the restructuring was an exchange or non-exchange arrangement i.e.,

Group 1 – within a public sector version of IFRS 3:

- Exchange - not under common control; and
- Exchange - under common control; and

Group 2 – separate IPSAS project;

- Non-exchange - not under common control; and
- Non-exchange - under common control.

Some support was expressed for this approach though it was noted that IFRS 3 currently scopes out business combinations under common control. An alternative suggestion to improve user friendliness was to re-consider the proposed headings for the groups, in particular, ‘transfer of functions’. Some considered that transfer of functions was not broad enough to encompass the various restructurings which could occur in that grouping.

Overall, the Board:

- agreed progressing the project using the groupings provided by staff (this position was subsequently reconsidered by the Board); and
- directed staff to reconsider the labels for group 1 and particularly group 2 to ensure they better encompass the broad suite of restructurings that could occur within each.

Staff then moved discussion to consider public sector specific issues associated with each of group 1 and group 2 restructurings.

Issues - Group 1 • not under common control - exchange

Non-GBE-Type Acquisitions

Staff noted the issue related to the acquisition of an entity whose under-lying assets predominately encompass service potential (eg: non-GBEs) vs economic potential (eg: GBEs). The recognition of goodwill/purchase premium for non-GBE-type entities was inconsistent with the existing definition of goodwill in IFRS 3 (which focuses on economic potential). Staff noted that the different treatment of goodwill based on the under-lying assets of the acquired entity formed the basis of existing guidance of the Canadian public sector accounting standards board.

In response to a question, staff clarified that any potential goodwill calculated would be based upon acquired assets which had been re-measured to fair value as at the acquisition date and therefore that re-measurement should encompass future service potential.

Given the clarification, members expressed concern at the inappropriateness of allocating costs to future periods for service potential. It was noted that some time in the future, there was the option for the recipient entity to re-measure its assets if it was felt that their full service potential was not correctly reflected in the existing carrying value.

As such, the Board expressed the preliminary view:

- supporting the Canadian approach that where the acquisition involved an entity where the under-lying assets predominately encompass service potential, any purchase premium/goodwill calculated after fair valuing the acquired identifiable assets and liabilities, should be immediately expensed;
- supporting staff's intention to review the definitions within IFRS 3 (eg: business, business combination) to take into consideration the service provision aspects of public sector entities.

- Issues - Group 2
- not under common control – non-exchange
 - under common control – exchange
 - under common control – non-exchange

In relation to group 2 restructurings, staff noted that the focus of the issues discussion would be on recognition, measurement and disclosures with brief discussion about terminology/definitions and presentation of the guidance within the IPSASB Handbook.

Recognition

Staff focused discussion on contribution by and distributions to owners and revenue and expense.

Staff led the IPSASB through existing guidance in IPSASs 1, *Presentation of Financial Statements* and 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* as well as the work of some national standard setters to assist in determining the most appropriate approach for recognition.

- Restructurings under common control – exchange and non-exchange: staff discussion focused on the key tenet that ultimately the controlling body is restructuring within itself. Supported by further rationale, staff advised that their preliminary view was that for such restructurings, recognition should be treated as a contribution/distribution by/to owner
- Restructurings not under common control - non-exchange: staff focused on the key tenet that the control of the body requiring or imposing the restructuring is often transitory in nature. As such, ultimately the controlling body is not restructuring

within itself. Given this, the staff preliminary view was that such restructurings should more likely be recognized as revenue and expense.

The Board re-considered an earlier expressed view that even when control is transitory, often in those situations, it could be considered that common control in substance actually exists over the entities being re-restructured. However, in one jurisdiction a constitutional challenge was raised in the courts over the ability of an upper-level of government to combine two municipalities - and the municipalities won. The outcome of the case provided evidence that the nature of the relationship between the parties perhaps was not as simple as what might have been thought.

In considering these views, the Board overall was comfortable with staff's preliminary views on recognition:

- under common control – exchange – contribution by and distributions to owners;
- under common control – non-exchange – contribution by and distributions to owners; and
- not under common control – non-exchange – more likely revenue and expense.

Measurement

Staff noted that there was much existing guidance on measurement developed by standard setters which focuses essentially on the acquisition approach ie: measuring acquired assets and liabilities at fair value with guidance on the treatment of goodwill.

- Restructurings under common control – exchange and non-exchange: as with recognition, staff discussion focused on the key tenet that no acquisition has occurred of an entity external to the government reporting entity - ultimately the controlling body is restructuring within itself. As such, the application of re-measurement principles did not appear appropriate. Re-measurement could result in the creation of artificial gains/losses and impose costs for both the revaluation and subsequent consolidation adjustment for the group reporting entity.

As such, staff provided the preliminary view that for restructurings under common control, carrying value for the assets and liabilities impacted by the restructuring provides a better reflection of the substance of the transaction.

Board members were comfortable with staff's preliminary view to progress the project using carrying value as the measurement basis for restructurings under common control – exchange and non-exchange.

- Restructurings not under common control – non-exchange: staff noted that much existing guidance indicated fair value as the appropriate measurement basis, most notably IPSAS 23 which requires an asset acquired through a non-exchange transaction to initially be measured at fair value.

Staff noted that the application of a fair value measurement (an arms-length valuation basis) to a non-acquisition restructuring which will often not be an arms-length arrangement (eg: forced restructuring of municipalities), appeared inconsistent.

As such, staff revised its preliminary view so that for restructurings not under common control - non-exchange, that carrying value provides a better reflection of the substance of the transaction.

A member noted that in guidance they are developing, fair value was the measurement basis being proposed in these circumstances for the recipient with cost being the basis for the transferor. A key reason supporting this proposal was the existing guidance of standard setters where the combination occurs not under common control – further, the requirements on IPSAS 23 were relevant.

In response it was raised that re-measurement in these circumstances seemed questionable – and further that it could be that carrying value and fair value would often be very similar. An additional comment was made that carrying values were most appropriate noting that the recipient entity does have the choice to perform a complete revaluation after the restructuring has concluded. A suggestion was made if there was a possibility to allow, only when a restructuring occurs, a one-off revaluation to be applied by the recipient which does not place them on a revaluation model.

While the Board was finding a preference for the use of carrying values, there was the question of how to reconcile with the fair value basis in IPSAS 23. Staff noted the inconsistency agreeing the need to reconcile the two. Further, staff highlighted that in reconciling with IPSAS 23, reconciling with IPSASs 12, *Inventories*, 16 *Investment Property* and 17, *Property, Plant and Equipment* would also need to be addressed.

A suggestion put forward was to possibly distinguish between IPSAS 23 and the restructuring by viewing one as a combination and the other as an acquisition. A further suggestion was to somehow amend or further refine the application of IPSAS 23 to a very particular unique circumstance. Staff agreed to further consider all these suggestions.

Therefore, subject to staff reconciling with IPSAS 23 (and other IPSASs), Board members were comfortable progressing the project using carrying value as the measurement basis for restructurings not under common control – non-exchange.

- Mergers: staff briefly discussed possible issues where there is a merger – notably considering the merits of fresh start accounting.

Staff considered that why there may be merits to fresh start accounting, the reality was arguably that for mergers in the public sector, the substance of the combining entities would continue to exist though within a new legal structure. Further, from a pragmatic perspective, pooling of interest was considered a very well established and

understood approach. However with fresh start, the broad concepts tended to well understood with agreement on its detailed application appearing to be less commonly understood.

As such, staff provided the preliminary view that in merger situations, carrying values (pooling of interest) should be the measurement basis.

The Board was informed of a jurisdiction where there was the potential for fresh start accounting possibly being a more appropriate basis for the some 2700 entities which were merging into one combined entity. The Board acknowledged the uniqueness of this situation and requested staff to take such combinations into consideration – with the possibility of seeking out the experience of members to see if there were any other instances where fresh start accounting could be more appropriate.

It was suggested if fresh start accounting should be provided in the IPSAS guidance as an allowable alternative. The general view of the Board was to minimize alternatives within standards. Further it was considered that generally, the substance of the merged entity has not changed and therefore made it questionable as to the appropriateness of applying fresh start accounting. Further a comment was made that existing literature does not appear to have any detailed guidance on the application of the fresh start approach, and as such, to allow it as an allowable alternative within an IPSAS could further broaden the dimensions of any IPSASB project.

A question was posed about the practicalities of preparing financial statements for the merged entity, in particular, the reporting period applied. It was brought to the Board's attention that in one jurisdiction, such mergers are legislated to only occur at the commencement of the financial year. As such, there was no need to prepare financial statements for a partial period for the merged entity. Given this legislative requirement, 'cut-off' between the old and combining entities was relatively clean. Another noted that in their experience the most usual circumstance was that a set of financial statements are prepared for the newly merged entity from the date of merger until the reporting date – even is this constitutes reporting for part of a period.

Given the discussion the Board was comfortable progressing the project with staff's preliminary view of applying the pooling of interest (carrying value) approach.

Disclosures

Staff gave the Board a brief overview of possible themes for disclosures. Overall the Board considered the disclosures reasonable. There was discussion that those relating to matters such as rationale or planned objectives from the restructuring or explanations as to why the chosen method of restructuring (eg:merger) was used, were better reflected in, for example, management commentary.

As such the Board was comfortable progressing the project with staff's suggestions for disclosures except those relating to planned objectives or explanations as to why the chosen method of restructuring was used.

Presentation within the IPSASB Handbook

While cosmetic in nature staff presented (if only for the Board's re-affirmation) the preliminary view that final guidance on the project should be broken into two separate IPSASs. The Board was comfortable with this preliminary view.

Finally, staff gave a broad outline of planned timeframes of next steps for the project:

- November 2008: a preliminary draft of a public sectorized version of IFRS 3;
- February 2009: draft exposure draft of IFRS 3 and a draft discussion paper for the group 2 restructurings (non-exchange only).

Grouping of Restructurings - Reconsidered

In providing a staff summary of preliminary views agreed by the Board, there was a reconsideration of the need for the project to consider those restructurings under common control – exchange. There was concern as to the reality of occurrence of such restructurings. Instead, some believed that out of the group 2 restructurings, the project should only focus on non-exchange restructurings. In doing so, the Board could aim for a quick completion of an ED based on IFRS 3 for exchange transactions not under common control and focus energies into a project which deals with the more problematic non-exchange restructurings which are more commonplace in the public sector.

Opposition to the suggested scope out of restructurings under common control – exchange was not noted, and as such staff agreed to scope the group 2 restructurings to non-exchange restructurings only.

Staff were cautioned against characterizing numerous types of restructurings as being public sector specific. While the reality might be, for example, that common control restructurings are more frequent in the public sector, that did not make them a public sector specific occurrence. Such restructurings and related issues could occur in the private sector. Staff agreed and noted the point for future reference.

Summary of Board Decisions

- *Grouping of Restructurings -*
 - Group 1:
 - not under common control – exchange; and
 - Group 2:
 - under common control – non-exchange; and
 - not under common control – non-exchange; and

- staff to reconsider the labels for group 1 and particularly group 2 to ensure they better encompass the broad suite of restructurings that could occur within each; and
- staff to be cautious against characterizing numerous types of restructurings as being public sector specific; and
- *Issues - Group 1*
 - Non-GBE-Type Acquisitions:
 - where the acquisition involves an entity whose under-lying assets predominately encompass service potential, any purchase premium/goodwill calculated after fair valuing the acquired identifiable assets and liabilities, should be immediately expensed; and
 - review the definitions within IFRS 3 (eg: business, business combination) to take into consideration the service provision aspects of public sector entities; and
- *Issues – Group 2*
 - Recognition:
 - under common control – non-exchange – contribution by and distributions to owners; and
 - not under common control – non-exchange – more likely revenue and expense; and
 - Measurement:
 - All group 2 restructurings to be at carrying value; and
 - seek examples where fresh start accounting may be appropriate; and
 - Disclosures - progress with staff’s suggestions except those relating to planned objectives or explanations for the chosen method of restructuring; and
- *Presentation within the IPSASB Handbook* – the Board re-affirmed that final guidance from the project should be broken into two separate IPSASs.

March 2007

9. Entity Combinations

Staff presented a project brief acknowledging that earlier Board discussions about the IPSASB strategic plan, in particular, future projects both selected by the Board and timeframes for their commencement, would influence proposed timeframes in the brief.

In reviewing the brief, the Board considered that overall, IFRS 3 *Business Combinations* is convergent for the public sector – in particular application of the purchase/acquisition method. However, the Board believed there to be numerous entity combinations occurring in the public sector for which application of the purchase/acquisition method would not be the most appropriate method of accounting.

Entity combinations could often result in there not necessarily being an acquirer or control. As such, the Board wanted a fuller understanding of a broader range of entity combinations occurring in the public sector – which would help in scoping what could be a very significant portion of an overall entity combinations project.

Examples of entity combinations for which the application of the principles of IFRS 3 could be problematic included (but not necessarily limited to);

- entities under common control;
- amalgamations of cities/municipalities; and
- transfer of activities from central government to local government or vice versa.

To help discussion on next steps for a project, the Board requested an issues paper be developed which considered accounting issues associated with these combinations and others. To assist in making the issues paper as comprehensive as possible, the Board asked for the opportunity to provide examples of combinations which they would like to see reflected in the paper. Further, requests were made for the paper take into account fair value considerations and also issues related to combining entities with different accounting policies. The paper will be provided later in 2007.