



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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**Agenda Item
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Date: November 21, 2011
Memo to: Members of the IPSASB
From: Annette Davis
Subject: Entity Combinations

Objective of this Session

- To **discuss** and **provide directions** on proposed revisions to the definitions related to entity combinations.
- To **discuss** and **provide directions** on the draft Consultation Paper, *Entity Combinations*.

Agenda Material

- 2.1 Issues Paper: Working Definitions
- 2.2 Draft Consultation Paper, *Entity Combinations*

Issues Paper: Working Definitions

1. Agenda Paper 2.1 deals with proposed revisions to the working definitions. In particular, it discusses a suggestion from the September 2011 meeting to replace the term “control” with the description used in Conceptual Framework Exposure Draft 1, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity* (CF-ED 1).

Draft Consultation Paper, Entity Combinations

2. Agenda Paper 2.2 is the draft Consultation Paper. The IPSASB, at its September 2011 meeting, agreed that the draft Consultation Paper (CP) should be structured to discuss acquisitions and amalgamations under common control, and, separately, acquisitions and amalgamations not under common control. Because of the work required to make this change, the draft CP presented at this meeting includes only sections on acquisitions and amalgamations not under common control.
3. In relation to entity combinations under common control, Staff notes that the European Financial Reporting Advisory Group (EFRAG) issued a Discussion Paper, *Accounting for Business Combinations under Common Control* (BCUCC) in October. This discusses the issues relating to BCUCC within the framework of

- applying IFRSs, i.e., it has been developed from the perspective of profit-oriented entities. Staff has not fully considered the implications of this Discussion Paper, but will do so in early 2012. The Discussion Paper is accessible on EFRAG's website: www.efrag.org
4. The draft CP includes a “potential preliminary view” **only** where the IPSASB has formed a view at previous meetings. The text immediately below the title of the preliminary view indicates the meeting at which the view was formed. Obviously, where the IPSASB agrees that it would be better not to include a view, these can be deleted.
 5. The draft CP also includes a section on acquisitions of entities in financial distress, as suggested at the September 2011 meeting, and a section on acquisition-related costs, which has not previously been discussed.
 6. Appendix A includes an extract of the draft minutes from the September 2011 meeting relating to entity combinations.

Appendix A: Extract from Draft Minutes of September 2011 Meeting

10. ENTITY COMBINATIONS

Discuss issues (Agenda Item 10)

The staff presented an issues paper which included four issues: (1) proposed revisions to the definitions related to entity combinations; (2) distinguishing between types of entity combinations and the related accounting treatment; (3) the relationship between entity combinations and the entering into of a joint venture; and (4) the existence of minority interests.

Working definitions

Staff proposed that the working definition of an entity combination be changed from an overarching definition to a lower-level definition relating only to situations where a recipient gains control of one or more operations. The IPSASB disagreed with this proposal and suggested instead that the overarching definition of an entity combination is kept and the term “acquisition” is used for situations where a recipient gains control of one or more operations.

A Member suggested that the working definition of an operation, set out below, should be amended (set out in marked-up format):

“An integrated set of activities and assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving the entity’s objectives, either by providing economic benefits or service potential.”

The reason for this suggested amendment is that if there are no assets there does not seem to be an accounting issue. The IPSASB generally agreed with this amendment.

Members commented that the notion of control of an entity in IPSAS 6, *Consolidated and Separate Financial Statements* and control of assets being developed in Phase 2 of the Conceptual Framework project, *Elements and Recognition in Financial Statements* were different. A Member noted that existing IPSASs use control to address both the control of an entity and the control of an asset. Members agreed to explore replacing the term “control” with the more expansive phrase such as that used in the Consultation Paper on Phase 1 of the Conceptual Framework project¹, in the definition of an entity combination. However Members did note that to be successful, this change in wording

¹ Paragraph 5.19 of the CF-CP on Phase 1 states:
“This section reflects the view that a whole of government group reporting entity will comprise the government and other entities when the following criteria are satisfied:

- The government has the power to govern the strategic financing and operating policies of those entities (“power” criterion); and
- The government (a) can benefit from the activities of those entities, or is exposed to a financial burden that can arise as a result of their operations or actions, and (b) can use its power to increase, maintain, or protect the amount of those benefits, or to maintain, reduce, or otherwise influence the financial burden that may arise as a result of the operations or actions of the other entity (“benefit or financial burden/loss” criterion).

would need to articulate with the definition of control in IPSAS 6 and other related IPSASs.

The IPSASB discussed the proposal to use the term “amalgamation” and the related definition rather than “merger”. The IPSASB agreed with these proposals.

Entity combinations under common control (now – “Acquisitions under common control”)

The staff proposed for acquisitions under common control that the recipient should use carrying amount for the newly-controlled operation. Members suggested that this section should be expanded and clearly explain the appropriateness of using carrying amount and why fair value was not appropriate. Additionally, the explanation should include discussion relating to the accounting of the economic entity for this transaction or other event, including the intention of the ultimate controlling entity, and then discuss the accounting treatment of the acquisition in the reporting entity. The comments on carrying amount being practical or low cost should not lead the discussion of the advantages of carrying amount.

Staff proposed that the recipient in an acquisition under common control should recognize the difference arising from the net assets received or net liabilities assumed and the consideration transferred (if any) as a contribution from owners. The IPSASB disagreed with this proposal and considered it should go directly to net assets/equity, but it would not necessarily be a contribution from owners as there are different types of net assets/equity transactions.

Entity combinations not under common control (now – “Acquisitions not under common control”)

The staff proposed an approach to determining which measurement basis or approach to use based on which sector the transferor belongs to, i.e., the public sector or the private sector. The IPSASB discussed this approach and considered that it was problematic because the distinction between the two sectors is not always clear. Without reaching a view on measurement bases, they agreed that entity combinations should be distinguished according to whether they occurred under common control. The draft Consultation Paper (CP) should explain that other approaches had been considered.

The IPSASB agreed that the draft CP should be structured to discuss acquisitions and amalgamations under common control and acquisitions and amalgamations not under common control rather than separately discussing amalgamations.

A Member suggested that there should be exploration of whether another measurement basis would be appropriate in certain circumstances where a public sector entity is an unwilling buyer and acquires a private sector entity to ensure that the value of that entity does not devalue down to market value. The public sector entity acquires it because it wants that entity to continue rather than going into liquidation. The Member suggested that a discounted cash flow approach might be appropriate. Other Members considered that this approach would result in a marginal difference in amount compared to using market value or fair value.

A Member added that the valuation was affected by a timing difference between the acquisition of an entity with distressed assets and its subsequent performance (where that performance is good). It was clarified that the issue relates to the fact that a government can deal with liquidity risk that private sector entities are not able to and this aspect is not reflected when using fair value as a measurement basis. The IPSASB agreed that this issue should be included in the draft CP but that it would be complex to operationalize. It is likely to be a value-in-use measurement basis and depending on the assets involved would use replacement cost or discounted cash flows and would need to include a discussion on the consideration transferred as that is usually recognized at fair value.

Another aspect to be included is whether the intention of the government matters, e.g., the intention to sell in IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* uses a different measurement basis².

The IPSASB considered the appropriate accounting treatment of the difference arising from the net assets received or net liabilities assumed and the consideration transferred (if any) in the recipient's consolidated financial statements. Members made the following comments:

- Where the amount of consideration transferred is in excess of the net assets received, Table 4 gives the choice of recognizing a gain or goodwill. The draft CP should also include the option of a free choice.
- The draft CP should also discuss whether there is a difference if the newly controlled operation has mostly cash-generating or non-cash-generating assets.
- Paragraph 81 is not a convincing argument to treat the difference arising as a gain particularly as a gain is most probably the result of an exchange transaction.
- Paragraph 96 is worded incorrectly (and in flowchart).
- Question 17 and paragraphs 120 and 124 refer to goodwill being “capitalized” and it should be “recognized”.

Formation of a joint venture

The IPSASB agreed that the scope of this project should include only the acquisition of a joint venture because the accounting for the formation of a joint venture is dealt with in IPSAS 8, *Interests in Joint Ventures*. Members commented that amendments could be made to improve the clarity of this section, in particular so that it is clearer whether jointly controlled assets are in the scope of this project.

Minority interests

The IPSASB generally agreed with the discussion on minority interests. Members made the following comments:

- Where an entity combination takes place under common control, the initial measurement of a minority interest would be limited to the minority interest's proportionate share of the newly controlled operation's net assets.
- An amalgamation may include minority interests (i.e., where minority interests exist before the amalgamation takes place and this should be considered in the draft CP).

² IFRS 5.15 requires a non-current asset (or disposal group) classified as held for sale to be measured at the lower of its carrying amount and fair value less costs to sell.

The IPSASB agreed that the measurement of a minority interest should be the minority interest's proportionate share of the newly controlled operation's net assets.

Next steps

The staff noted the draft CP including these issues will be presented at the December 2011 meeting. The IPSASB directed the staff to include a fuller discussion of issues in the draft CP.

ENTITY COMBINATIONS

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Objective of this Issues Paper

- To **discuss and provide directions** on proposed revisions to the definitions related to entity combinations.

Working Definitions

Background

1. At the September 2011 meeting, the IPSASB agreed that the working definition of an entity combination would be the overarching term that will encompass two types of entity combinations, i.e., acquisitions and amalgamations.
2. At that meeting there was a suggestion that the definition of amalgamation could be amended to refer to none of the combining entities or operations gaining **sole** control of the other entities and/or operations because the addition of “sole” would explicitly exclude the possibility of the definition including the formation of a joint venture which requires “joint control.” Staff has considered this suggestion and does not think that the additional word is necessary because when the term “control” is used it means, and is widely understood to mean, sole control, rather than joint control.
3. The IPSASB also made a decision to explicitly exclude the formation of joint ventures from the scope of this project. This explicit exclusion should help minimize the potential confusion as to whether the formation of a joint venture meets the definition of an amalgamation.
4. For the above two reasons, the suggestion to include the word “sole” is not reflected in the definitions below. The definition of an entity combination has been amended to refer to the two types of combination that the definition encompasses, i.e., acquisitions and amalgamations.

Table 1: Working Definitions

An entity combination is the bringing together of separate entities and/or operations into one entity <u>either as an acquisition or an amalgamation</u> .
An acquisition is a transaction or other event where a recipient gains control of one or more entities and/or operations.
An amalgamation is a transaction or other event where two or more entities and/or operations combine and none of the combining entities or operations gain control of the other entities and/or operations.

5. At the September meeting, the working definition of an operation was worded as follows:
“An integrated set of activities, assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving the entity’s objectives, either by providing economic benefits or service potential.”

6. The IPSASB discussed whether the phrase in the definition “...activities, assets and/or liabilities...” should be amended so that the definition of an operation would not be met where there are activities and liabilities but no assets. The IPSASB agreed that, to meet the definition of an operation, assets should be a required component of the definition because “a integrated set of activities and liabilities...” alone are not able to meet the rest of the definition, i.e., “... for the purpose of achieving the entity’s objectives, either by providing economic benefits or service potential.”
7. The revised working definition is set out below.
“An integrated set of activities **and** assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving the entity’s objectives, either by providing economic benefits or service potential.”
8. This definition is consistent with the IASB’s definition of a business¹ in that both require activities and assets to be present for the definition to be met.
9. Where an entity combination is the bringing together of “separate entities” rather than the bringing together of “separate operations”, the “entity” that the recipient gains control of in an acquisition also needs to have activities and assets, in the same way that an operation does. Similarly, where “combining entities” are brought together into the resulting entity, they need to have activities and assets, in the same way that combining operations do.

Question 1 for the IPSASB:

Do you agree with the working definitions of entity combination, acquisition, amalgamation (set out in Table 1) and operation (set out in paragraph 7)?

Proposal to Amend Definitions to Replace the Term “Control” with a Description

10. At the September 2011 meeting there was a suggestion that the term “control” used in the definitions of acquisition and amalgamation could be replaced with a description of control which is used in CF-ED 1² in relation to the composition of the group reporting entity. This suggestion was made to avoid the potential for confusion due to the fact that the notion of control [of an entity] may not include the same features as the notion of control [of an asset]. The notion of control [of an entity] is used in IPSAS 6, *Consolidated and Separate Financial Statements*, which is relevant to this project and so included in the definitions of acquisition and amalgamation. The notion of control [of an asset] is being used to develop the definition of an asset in deliberating the responses to the Conceptual

¹ Appendix A of IFRS 3 defines business as: “An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.”

² *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity*, issued in December 2010.

- Framework Consultation Paper (CF–CP 2), *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements*, which was issued in December 2010.
11. The IPSASB has an existing definition of an asset, as follows.
“**Assets** are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.”
 12. This definition is included in IPSAS 1, *Presentation of Financial Statements*. It is based on the IASB’s *Framework for the Preparation and Presentation of Financial Statements* which defines an asset as:
“A resource:
 - (a) Controlled by an entity as a result of past events; and
 - (b) From which future economic benefits are expected to flow to the entity.”
 13. The IASB has a joint project with the US FASB to revise and converge their respective Conceptual Frameworks. However, that project is currently on hold until the IASB concludes its agenda consultation. In relation to elements, the IASB-FASB has not yet issued a Discussion Paper.

Existing Guidance on “Control”

14. The *Glossary of Defined Terms* defines “control,” as follows.
“The power to govern the financial and operating policies of another entity so as to benefit from its activities.”
15. Though not described as such, this definition has clearly been developed to apply to control of an entity, rather than control of an asset. It is used in IPSAS 6 to determine whether an entity controls another entity. It is based on the definition of control in the underlying standard, IAS 27, *Consolidated and Separate Financial Statements* issued in December 2003.
16. The IPSASB has commenced a project to revise IPSASs 6–8, so that these standards maintain alignment with the underlying IFRS. The IASB issued new and revised underlying standards in May 2011 which means that is an appropriate time to revise IPSASs 6–8.
17. The *Glossary of Defined Terms* also defines “control of an asset,” as follows.
“Arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives, and can exclude or otherwise regulate the access of others to that benefit.”
18. This definition is used in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* to determine when an entity should recognize an asset received as part of a non-exchange transaction. IPSAS 23 is a public sector specific standard developed by the IPSASB to address the issue of how to account

for revenue from non-exchange transactions³. The IASB does not define “control of an asset.”

Proposal to Replace the Term “Control” with a Description

19. The term “control” is used in the working definitions of acquisition and amalgamation. The suggestion at the September 2011 meeting was to replace the term with the description used in CF–ED 1 that “the disclosure of information about the resources, obligations and service delivery or other activities that a government as a whole (or other public sector entity) has the authority and capacity to direct, including those it can direct through other entities, will be necessary for accountability and decision-making purposes when the results of such direction can generate benefits for the government (or other public sector entity) or expose it to a financial burden or loss.”⁴
20. Appendix A contains an extract from CF–ED 1 of the relevant paragraphs of Section 4, *The Reporting Entity and Group Reporting Entity*. CF–ED 1 uses the term “group reporting entity” rather than economic entity.
21. When developing the Phase 1 Conceptual Framework Consultation Paper⁵, the IPSASB considered a wide range of potential bases for determining the composition of a public sector group reporting entity and determined that the Conceptual Framework should identify the circumstances that justify inclusion of an entity or activity within a public sector group reporting entity, without designating those circumstances as reflecting a “control,” “accountability,” “oversight,” or some other basis. One of the reasons for this decision is that these terms are interpreted differently in different jurisdictions.
22. Whilst CF–ED 1 focuses on the underlying principles of a group reporting entity it acknowledges that specific applications of these principles will be dealt with at the standards level⁶.
23. Before the IASB-FASB put its Conceptual Framework project on hold, they issued an Exposure Draft, *Conceptual Framework for Financial Reporting: The Reporting Entity* in March 2010. This phase of their Conceptual Framework project is also on hold, pending the outcome of the IASB’s deliberations about its future work plan.
24. The amended definition of acquisition and amalgamation are set out below, which includes the text from CF–ED 1.

³ The IASB only partially addresses the issue of non-exchange transactions because non-exchange transactions are not prevalent in the for-profit private sector. Its standard, IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*, addresses non-exchange transactions from the perspective of a private sector entity receiving a government grant.

⁴ CF–ED 1, paragraph 4.9.

⁵ Consultation Paper, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: The Objectives of Financial Reporting; The Scope of Financial Reporting; The Qualitative Characteristics of Information Included in General Purpose Financial Reports; The Reporting Entity*, issued in September 2008.

⁶ CF–ED 1, paragraph BC4.17.

Table 2: Proposed Working Definitions Replacing the Term “Control” with a Description

An **acquisition** is a transaction or other event where a recipient gains the authority and capacity to direct ~~control of~~ one or more entities and/or operations and the results of such direction generate benefits or expose it to a financial burden or loss.

An **amalgamation** is a transaction or other event where two or more entities and/or operations combine and none of the combining entities or operations has the authority and capacity to direct ~~gain control of~~ the other entities and/or operations to generate benefits or expose it to a financial burden or loss.

25. Removing the term “control” and inserting the equivalent description from CF–ED 1 has lengthened the definitions considerably. It also means that the use of control throughout the draft CP will need to be replaced with the long form criteria. Unless the IPSASB wishes to identify another “umbrella term” to replace control and encompass these criteria, this is likely to add drafting complexity to the draft CP.

Staff Analysis

26. The definition of control is in IPSAS 6 because it is that standard which determines the entities that should be included in an economic entity at each reporting date.
27. CF–ED 1 explained that the IPSASB did not use the term control to identify the boundary of a group reporting entity because the IPSASB determined that the Conceptual Framework should identify the circumstances that justify inclusion of an entity or activity within a group reporting entity without using a specific term. Rather, the IPSASB has used long form criteria and identified principles underlying those criteria as: “the authority and capacity to direct, including those it can direct through other entities ... when the results of such direction can generate benefits for a [group reporting entity] or expose it to a financial burden or loss.” However, the development of specific criteria will be dealt with at the standards level.
28. As staff has explored this aspect of the IPSASB’s direction from the September 2011 meeting, staff is uncomfortable about extending the scope and objectives of this project to also include reconsideration of the use of, and the definition of, control as the basis for determining the combination of a group reporting entity.
29. Staff is of view that the issue is much broader than the objective contemplated for this project. Therefore, work relating to the revision of the term control, or its replacement with another term, should be undertaken in the revision to IPSASs 6–8 project.
30. As the revision of IPSAS 6–8 project progresses, any implications regarding the reconsideration of the use of the term “control” and its definition may influence the development of this project.

31. Therefore, staff proposes that, at this stage, the entity combinations project should continue to be developed within parameters of IPSASs 6–8, i.e., with the terminology and definitions used in IPSASs 6–8. However, staff also proposes that the draft CP explicitly acknowledges the relationship of this project to (a) the revision of IPSASs 6–8 in relation to the definition and use of the term “control” and (b) the proposals included in CF–ED 1, and that developments in these projects will be considered in this project.

Question 2 for the IPSASB:

Do you agree that the working definitions of acquisition and amalgamation should continue to use the term “control”?

Appendix A: Extract from CF-ED 1: The Reporting Entity and Group Reporting Entity

4. The Reporting Entity and Group Reporting Entity

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The Group Reporting Entity

- 4.7 A government frequently has the authority and capacity to direct the activities of one or more entities so as to benefit from the activities of those entities. It may also be exposed to a financial burden or loss that may arise as a result of the activities of entities whose activities it has the authority and capacity to direct. Other public sector reporting entities, including government departments, agencies or programs may also have the authority and capacity to direct the activities of other entities and to benefit and/or be exposed to a financial burden or loss as a result.
- 4.8 The benefits derived by the government (or other public sector entity) from the entities whose activities it has the authority and capacity to direct may be financial, such as a dividend or other distribution of the surplus of a GBE or a reduction in the loss or financial burden that it would otherwise have been exposed to. However, because governments and many other public sector entities are established primarily to provide services to members of the community rather than to generate a financial return, those benefits may also be an ability to direct that other entity to work with the government (or other public sector entity) to achieve its service delivery objectives, including the provision of services to constituents. A financial burden or loss may arise if the government (or other public sector entity) is legally obligated, or otherwise assumes an obligation, to provide financial support to that other entity by, for example, financing its deficits or settling its residual liabilities if it is dissolved, or to assume the provision of services that the entity would otherwise provide.
- 4.9 The disclosure of information about the resources, obligations and service delivery or other activities that a government as a whole (or other public sector entity) has the authority and capacity to direct, including those it can direct through other entities, will be necessary for accountability and decision-making purposes when the results of such direction can generate benefits for the government (or other public sector entity) or expose it to a financial burden or loss.
- 4.10 When GPFs for a group reporting entity are prepared, they will present information about, for example, all the resources of the entities that make up that group, claims to those resources, and other aspects of the financial position, performance and achievements of those entities as if they are a single entity. They will also present prospective financial and non-financial information as required by IPSASs.

The Authority and Capacity to Direct the Activities of another Entity

- 4.11 A government (or other public sector entity) may possess the authority and capacity to direct the activities of another entity even though it chooses not to exercise that authority. In many cases, it will be clear when a government (or other public sector entity) has the authority and capacity to direct the activities of another entity—for example, it may be specified in the enabling legislation that established the entity, or in formal contractual or other agreements that relate to its operation. Similarly, in the case of GBEs and other entities that adopt a corporate structure, the government (or other public sector entity) may hold a majority shareholding or other equity interest that confers rights to direct the financing and operating policies of that other entity. It may also be clear when such authority and capacity does not exist—for example the government (or other public sector entity) will not possess that authority and capacity if it requires changes in legislation, establishment of new (or renegotiation of existing) contracts and agreements or changes in ownership rights for that authority and capacity to be effective. However, in other cases, the exercise of professional judgment may be necessary in determining whether such authority and capacity exists.
- 4.12 In some cases, a public sector entity may have the authority to direct the activities of another entity in the capacity of a trustee or agent, but cannot exercise that authority to increase the benefits it receives from, or influence the financial burden imposed on it by, the other entity. In other cases, a public sector entity may benefit, or be subject to a financial burden or loss, as a result of the actions of an entity whose activities it cannot direct. In each of these cases, the nature of the relationship between the entities is such that presenting GPFRs of a group reporting entity that comprises the public sector entity and these other entities would not achieve the objectives of financial reporting.

Jurisdictional Differences

- 4.13 IPSASs apply across jurisdictions that adopt different forms of government and different institutional and administrative arrangements for the delivery of services. IPSASs that give authority to the principles for determining the whole of government or other public sector group reporting entity will need to respond to operational and implementation issues that may arise in different jurisdictions.

4 Basis for Conclusions

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The Group Reporting Entity

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Determining the Group Reporting Entity

- BC4.9 In developing its Preliminary View on the group reporting entity in the Phase 1 CP, the IPSASB considered a wide range of potential bases for determining the composition of a public sector group reporting entity, including those

described as the “control basis,” “accountability basis,” and “oversight and substantial influence.” Other bases considered included those described as the “majority of risks and rewards basis,” “common control basis,” “operations covered by a public budget,” and “operations with a similar function or purpose.”

- BC4.10 Many of these bases have common features and, in some cases, GPFs prepared consistent with one basis can present information about the resources, obligations, and activities of a group reporting entity that is similar to a group identified under other bases. However, the bases also differ in some respects, and can have different meanings in different jurisdictions. Consequently, the IPSASB determined that the Conceptual Framework should identify the circumstances that justify inclusion of an entity or activity within a public sector group reporting entity, without designating those circumstances as reflecting a “control,” “accountability,” “oversight,” or some other basis.
- BC4.11 Consistent with the principles identified in the Conceptual Framework, a group reporting entity may comprise a government and all the statutory authorities, government business enterprises and other entities whose activities it can direct for its benefit, including those which expose it to a financial burden or loss. A group reporting entity may also constitute a ministry or a sector of government—for example, a government department and all the agencies and statutory authorities whose activities it can direct.

The Authority and Capacity to Direct the Activities of Other Entities

- BC4.12 The Phase 1 CP identified the government’s (or other entity’s) “power to govern the strategic financial and operating policies” as one of the criteria to be satisfied for inclusion in a group reporting entity. Some respondents to the Phase 1 CP expressed concern that use of the term “power to govern” may be interpreted as “power to regulate,” and this may result in the inclusion of additional and unintended entities in the group reporting entity.
- BC4.13 The IPSASB also notes that underpinning the views expressed by some respondents is a more fundamental concern: that whether or not the capacity to govern the strategic financial and operating policies of another entity would justify the inclusion of an entity in a group reporting entity should be dealt with more expansively at the standards development level, and should include additional direction on what constitutes “strategic financial policies” and “strategic operating policies.” The IPSASB has responded to these concerns by referring more broadly to the underlying principles and circumstances that would give rise to a group reporting entity.

The Capacity to Benefit or be Exposed to a Financial Burden or Loss

- BC4.14 This Conceptual Framework reflects the view that, to satisfy the objectives of financial reporting, GPFs of a group reporting entity should present financial and non-financial information as specified in IPSASs about the government (or other public sector entity) and the entities whose activities it has the authority

and capacity to direct, when the results of such direction can generate financial or other benefits for the government (or other public sector entity) or expose it to a financial burden or loss.

Application of the Principles in Particular Circumstances

BC4.15 The Phase 1 CP included the IPSASB's views on application of the principles to a number of circumstances including the composition of the whole of government group reporting entity in different forms of government, and whether a whole of government group reporting entity would include, for example:

- Public sector organizations with statutory or constitutional authority to be professionally independent—particularly where they are fully or substantially funded by public monies and subject to budget oversight; and
- Statutory authorities, GBEs, sovereign wealth funds and a range of what are known in some jurisdictions as “special purpose entities.”

BC4.16 Many respondents to the Phase 1 CP noted their agreement with the IPSASB's views about the consequences of application of the definition of the reporting entity and the criteria for inclusion of an entity within a group reporting entity in the specific circumstances dealt with. However, they also expressed concern that these were matters that were more appropriately addressed and resolved at the standards development level. Some respondents also expressed concern about some potential implications of the application of the criteria to circumstances that were not specifically addressed in the Phase 1 CP, including the relationship between national and state or provincial governments in some jurisdictions.

BC4.17 The IPSASB found these concerns persuasive. It has reconstructed its discussion of the reporting entity and group reporting entity to focus on the underlying principles. Specific applications of the principles will then be dealt with at the standards development level. This will ensure that the circumstances of particular jurisdictions are acknowledged in developing authoritative requirements that give effect to the principles identified in the Conceptual Framework.

BC4.18 The Conceptual Framework does not specify the basis on which financial statements for a group reporting entity are to be prepared, including for example:

- Whether, and in what circumstances, consolidated, combined or other financial statements should be prepared for a group reporting entity or components thereof; and
- The techniques to be adopted in compiling such statements.

The IPSASB is of the view that these are also matters that should be dealt with at the standards level.

DRAFT CONSULTATION PAPER

ENTITY COMBINATIONS

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1 Introduction

- 1.1 The objective of this Consultation Paper (CP) is to consider the recognition and measurement bases that are appropriate for a transaction or other event that gives rise to an entity combination in the general purpose financial statements (GPFs, hereafter, financial statements) of an entity that uses accrual based IPSASs.
- 1.2 The CP uses the term “entity combinations.” The term “business combinations” is the term generally used for this type of transaction or other event by profit-oriented entities. The IPSASB agreed that the term “entity combinations” should replace “business combinations” because the objective of a business is to generate profits, whereas one of the main objectives of a public sector entity is to deliver goods and services for community or social benefit, rather than to generate profits.
- 1.3 Many entity combinations in the public sector take place by way of non-exchange transactions whereas for profit-oriented entities the large majority of transactions are of a voluntary exchange nature. Exchange transactions are transactions where one entity receives assets or services or has liabilities extinguished and directly gives approximately equally value in exchange. Conversely, under a non-exchange transaction, an entity receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving equal value in exchange.
- 1.4 Entity combinations are prevalent in the public sector. Governments and public sector entities restructure for a variety of reasons, such as to achieve a more effective distribution of responsibilities and associated activities or to deliver a greater volume or better quality public services or goods. An entity combination may be undertaken voluntarily or can be required by legislation or other authority, e.g., legislation is enacted by a central government to reduce the number of local government entities with the aim of improving services and reducing costs.
- 1.5 Conceptual Framework Exposure Draft 1, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity* (CF-ED 1), issued by the IPSASB in December 2010, explains that “the objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFs for accountability purposes and for decision-making purposes.”¹ For accountability and decision-making purposes, users need to be able to evaluate the nature and financial effect of an entity combination that takes place during a reporting period.
- 1.6 Currently, IPSASs do not provide guidance on how to account for an entity combination which means that users may not be able to obtain the information needed to evaluate the nature and financial effect of an entity combination. This CP is the first step in determining the requirements and guidance appropriate for entity combinations in public sector entities.

¹ CF-ED 1, paragraph 2.1.

History of the Project

- 1.7 The IPSASB initially commenced a project on entity combinations in 2008. The project was split into two parts: (1) entity combinations arising from exchange transactions – a limited convergence project with IFRS 3, *Business Combinations*, and (2) entity combinations arising from non-exchange transactions – a public sector specific project.
- 1.8 The limited convergence project adapting IFRS 3, where appropriate, for the public sector, was undertaken because there are a few entity combinations in the public sector are similar to business combinations of profit-oriented entities. IFRS 3 is applied by profit-oriented entities and therefore the notion of a business combination being an exchange transaction in which willing parties exchange equal values is embedded into the Standard. It resulted in the issue of ED 41, *Entity Combinations from Exchange Transactions* in May 2009.
- 1.9 When reviewing the responses to ED 41, the IPSASB noted that IFRS 3 also addresses business combinations which result in a gain from a bargain purchase, i.e., the fair value of the net assets acquired is greater than the consideration transferred (amount paid). The IASB considers that bargain purchases are anomalous transactions because profit-oriented “entities and their owners generally do not knowingly and willingly sell assets or businesses at prices below their fair values”². Circumstances in which a bargain purchase may occur include a forced liquidation or a distress sale.
- 1.10 Because IFRS 3 includes bargain purchase situations, the IPSASB encountered difficulties in clearly distinguishing entity combinations arising from exchange transactions and entity combinations arising from non-exchange transactions. As a result, the IPSASB decided not to develop ED 41 into an IPSAS, and instead decided to develop this Consultation Paper, which includes in its scope all types of entity combination in the public sector.

² IFRS 3, Basis for Conclusions paragraph BC371

2 Scope and Definitions

Scope

- 2.1 The scope of this CP includes transactions or other events that give rise to an entity combination. An entity combination, as this term is used in the CP, refers to the bringing together of separate entities or operations into one entity³ and is not limited to one entity obtaining control of another entity. This CP therefore encompasses two types of entity combinations which are addressed in this CP:
- (a) An entity gains control of one or more entities and/or operations; and
 - (b) Two or more entities combine and none of the combining entities gain control of the other entities.
- 2.2 This Consultation Paper includes in its scope entity combinations not under common control (ECNUCC) and entity combinations under common control (ECUCC), undertaken with or without the transfer of consideration. Appendix A sets out examples of the types of transactions and other events that give rise to an entity combination that are included in this CP.
- 2.3 The IPSASB notes that the IASB, which sets accounting standards for profit-oriented entities has concluded that situations “in which none of the combining entities obtains control of the others are so rare as to be virtually non-existent.”⁴ Consequently, IFRS 3 requires a single method of accounting for business combinations. In other words, the identity of the entity that obtains control of another entity (the acquirer) is apparent in virtually all business combinations.
- 2.4 In contrast, the IPSASB believes that the occurrence of entity combinations in the public sector in which there is no acquirer or dominant entity occur with sufficient frequency as to require separate identification of these types of entity combinations. Therefore, it is important to distinguish between them so that an accounting method can be chosen for each that faithfully represents the economic substance of these transactions or other events and so that similar entity combinations are accounted for using the same method and dissimilar entity combinations are accounted for using a different method. Subsequent sections of the CP explore methods of accounting that could be applied.

Formation or Acquisition of a Joint Venture

- 2.5 A transaction or other event that results in the formation or acquisition of a joint venture may also meet the definition of an entity combination. This will be the situation when a venturer forms a joint venture and that joint venture is an entity or an operation. A venturer “is a party to a joint venture and has joint control over that joint venture.”
- 2.6 The definition of a joint venture is: “a binding arrangement whereby two or more parties are committed to undertake an activity that is subject to joint control.” In most cases the

³ This CP refers to an entity’s financial statements as applying, in the case of a single entity, to its financial statements or, in the case of an economic entity, to its consolidated financial statements.

⁴ IFRS 3, Basis for Conclusions paragraph BC35

formation or acquisition of a joint venture will an entity or an operation because a joint venture, by definition, includes an activity, so will usually meet the “integrated set of activities” part of the definition of an operation. Where the joint venture also has assets it will meet the second part of the definition of an operation. The gaining of joint control over a joint venture can be seen as similar to an acquisition because, in an acquisition, a recipient gains control of a newly controlled entity or operation. It differs from an amalgamation because, in an amalgamation, none of the combining entities or operations gain control over any of the other entities or operations.

- 2.7 Where separate entities and/or operations are brought together to form a joint venture, this transaction or other event will also meet the definition of an entity combination. However, accounting requirements for the formation of joint ventures is addressed in IPSAS 8, *Interests in Joint Ventures*. Therefore, this CP excludes from its scope the formation of joint ventures.
- 2.8 Similarly, where separate entities and/or operations are brought together by the acquisition of a joint venture, this transaction or other event will also meet the definition of an entity combination. However, IPSAS 8 does not include in its scope the acquisition of a joint venture. Therefore, this CP includes in its scope the acquisition of joint ventures (where the transaction or other event also meets the definition of an entity combination).
- 2.9 Paragraphs 4.58 and 4.59 consider implications for the accounting treatment of the acquisition of a joint venture where it also meets the definition of an entity combination.

Definitions

- 2.10 Across different jurisdictions, the terms used to describe an entity combination can vary. The paragraphs below explain the definitions used in this CP to ensure that an entity combination is referred to consistently.

Entity Combination

- 2.11 This CP uses an overarching definition of entity combination to describe two types of entities combinations:

“An entity combination is the bringing together of separate entities and/or operations into one entity either as an acquisition or an amalgamation.”

- 2.12 The definition of an entity combination includes the term “separate entities and/or operations.” The term “operation” is included so that an entity combination includes activities and assets and/or liabilities which are a component or part of an entity. An “operation” is defined as:

“An integrated set of activities and assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving the entity’s objectives, either by providing economic benefits or service potential.”

- 2.13 The definition means that the (1) gaining of control of an asset or a group of assets or (2) combining together of assets or groups of assets, that do not constitute an operation or operations, do not meet the definition of an entity combination. Guidance on the

accounting treatment of the (1) gaining of control of an asset or a group of assets or (2) combining together of assets or groups of assets, that do not constitute an operation or operations, is within the scope of other IPSASs.

- 2.14 The term “entity” is included because, in many instances, it is separate entities that are brought together in an entity combination. For the purposes of this CP, an entity must have the same characteristics as an operation, i.e., have an integrated set of activities and assets and/or liabilities, to meet the definition of an entity combination. This is necessary because an entity can exist without activities. This situation could arise, for example, where a controlling entity has a controlled entity with assets but no activities. To be within the scope of this CP, entities that are brought together into one entity must have activities and assets and/or liabilities. Guidance on the accounting treatment of entities that comprise (1) assets, (2) liabilities, or (3) assets and liabilities, that an entity gains control of or are combined together, is within the scope of other IPSASs.
- 2.15 In summary, an operation is part of an entity and an entity can comprise one or more operations.
- 2.16 The definition of an entity combination encompasses both acquisitions and amalgamations. These types of entity combinations are explained below.

Acquisition

- 2.17 This CP defines an acquisition as:

“A transaction or other event where a recipient gains control of one or more entities and/or operations.”

- 2.18 Where one entity gains control⁵ of one or more entities and/or operations during the reporting period, the entity that loses control of the entity or operation is the *transferor* and the entity that gains control of the entity or operation is the *recipient*. The entity or operation being acquired is the *newly controlled entity or operation*. The definitions of these terms are set out in Table 1 below.

Table 1: Definitions of the Parties in an Acquisition

A newly controlled entity or operation is the entity or operation that a recipient gains control of in an acquisition.
A recipient is the entity that gains control of one or more entities and/or operations.

⁵ The definition and use of the term “control” is being considered in the IPSASB’s project on the Revision of IPSASs 6–8, which comprises IPSAS 6, *Consolidated and Separate Financial Statements*, IPSAS 7, *Investments in Associates* and IPSAS 8, *Interests in Joint Ventures*. CD–ED 1 also considers how to determine the composition of a “group reporting entity” which is the term it uses in place of “economic entity.” CF–ED 1 uses long form criteria rather than the term “control.” Developments in these other projects may result in the use of a term other than “control.”

A **transferor** is the entity that loses control of one or more of its entities and/or operations to another entity (the recipient) in an acquisition.

- 2.19 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. The IPSASB considers that the use of these terms for entity combinations is consistent with the way the terms are used in IPSAS 23.
- 2.20 Whilst IPSAS 23 does not define recipient or transferor, the IPSASB considers it appropriate to define these terms in this CP because, unlike IPSAS 23⁶ it deals with both exchange and non-exchange transactions.

Amalgamation

- 2.21 This CP defines an amalgamation as:

“A transaction or other event where two or more entities and/or operations combine and none of the combining entities or operations gain control of the other entities and/or operations.”

- 2.22 Where two or more entities and/or operations combine during the reporting period and none of the combining entities or operations gain control of the other entities and/or operations, the entity that is the result of the amalgamation is termed the *resulting entity*. The entities and/or operations that combine are termed the *combining entities or operations*. An amalgamation may or may not involve the formation of a new entity as the resulting entity. The definitions of these terms are set out in Table 2 below.

Table 2: Definitions of the Parties in an Amalgamation

A **combining entity or operation** is an entity or operation that combines with one or more other entities and/or operations to form the resulting entity.

A **resulting entity** is the entity that is the result of two or more entities and/or operations combining where none of the combining entities or operations gains control

⁶ The System of National Accounts (SNA) 2008 also uses the term “transfer” to mean a non-exchange transaction. SNA 2008 defines “transfer” as “a transaction in which one institutional unit provides a good, service or asset to another unit without receiving from the latter any good, service or asset in return as a direct counterpart.”

of the other entities and/or operations.

Common Control

2.23 This CP includes within its scope acquisitions or amalgamations of entities or operations that are under common control. For the purposes of this CP “common control” is defined as:

“An entity combination in which all of the combining entities and/or operations are ultimately controlled by the same entity or entities both before and after the entity combination.”

3 Methods of Accounting for Entity Combinations and Measurement Bases

Methods of Accounting

- 3.1 In considering how to account for entity combinations in the public sector, this CP considers methods of accounting for business combinations in profit-oriented entities that have been applied in practice or have been proposed:
- (a) The purchase or acquisition method;
 - (b) The pooling method; and
 - (c) The fresh start method.
- 3.2 A description of each method and the measurement bases used is set out below.

The Purchase or Acquisition Method

- 3.3 A purchase or acquisition method of accounting has been applied in many jurisdictions. This CP describes the method as it is applied in IFRS 3, *Business Combinations*. IFRS 3 uses the term “acquisition method” because a business combination can occur in the absence of a purchase transaction⁷.
- 3.4 Under the acquisition method of accounting, one entity (the acquirer) obtains control of a business (the acquiree) in exchange for cash or other consideration. The acquirer recognizes and measures the identifiable assets acquired and the liabilities assumed of the acquiree at their fair value at the date of acquisition. There are limited exceptions to this approach to recognition and measurement. Any residual between the fair value of the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree, and the consideration transferred, is recognized as goodwill. If that difference is negative because the value of the acquired identifiable assets and liabilities exceeds the consideration transferred, the acquirer recognizes a gain from a bargain purchase.

Explanation of Fair Value

- 3.5 The *Glossary of Defined Terms* defines fair value, as follows.
- “The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.”*
- 3.6 This definition of fair value encompasses the amount that will be derived from an asset either from its use (service potential or economic benefits) or from its sale. An example of the use of fair value to measure an asset that will be held for use is the revaluation model in IPSAS 17. The revaluation model requires an asset to be valued at fair value (at the date of revaluation), less any subsequent accumulated depreciation, and subsequent accumulated impairment losses. Where there is no market-based evidence of fair value because of the specialized nature of the item, it can be estimated by using, for example,

⁷ IFRS 3, Basis for Conclusions paragraph BC14, 2008.

reproduction cost, depreciated replacement cost, or the restoration cost or service units approaches.

- 3.7 The IPSASB notes that the IASB has recently completed its project on fair value measurement and, as a result, has amended its definition of fair value to clarify that fair value of an asset relates only to its sale and not to the asset's value derived through its use by the entity⁸. This CP bases its explanation of fair value on the definition of fair value in IPSASs.

The Pooling Method

- 3.8 The pooling method of accounting has also been applied in many jurisdictions however; its use is currently prohibited in many jurisdictions. The reasons for this prohibition are explored below. This CP describes the pooling method as prescribed in IAS 22, *Business Combinations* issued in October 1998. IAS 22 was superseded by IFRS 3 in March 2004.
- 3.9 The pooling method is also known as the uniting of interests method or merger accounting.
- 3.10 The pooling method as prescribed in IAS 22 was limited to entity combinations where it is not possible to identify an acquirer, and thus applies to a sub-set of entity combinations. The premise of the pooling method is that the uniting of interests is the result of a transaction between owners of the combining entities rather than between the combining entities themselves. Instead of a dominant entity emerging, the shareholders of the combining entities join in a substantially equal arrangement to share control over the whole of the net assets and operations of the combined entity. As a result, the shareholders of the combining entities mutually share in the risks and benefits of the combined entity. Therefore, this type of entity combination must be undertaken with a substantially equal exchange of shares between the combining entities.
- 3.11 Under the pooling method, the assets, liabilities and net assets/equity of the combining entities for the period in which the combination occurs and for any comparative periods disclosed are included in the financial statements of the resulting entity at the amounts recognized by the combining entities, i.e., at carrying amount, and, as if they had been combined from the beginning of the earliest period presented.
- 3.12 The IASB prohibited the application of this method of accounting for business combinations when it issued IFRS 3. The IASB rejected the assertion that the pooling method is appropriate for true mergers because ownership interests are completely or substantially continued. The IASB is of the view that although ownership interests are continued in a combination effected by an exchange of equity instruments, those interests change as a result of the combination. The IASB considers the information provided by

⁸ The amended definition of fair value is “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date,” IFRS 13, *Fair Value Measurement*, Appendix A.

the pooling method would fail to reflect this change in ownership and would therefore not be a faithful representation of the transaction and its effects⁹.

Explanation of Carrying Amount

3.13 The *Glossary of Defined Terms* defines carrying amount, as follows.

“Carrying amount of an asset is the amount at which an asset is recognized in the statement of financial position, after deducting any accumulated depreciation and accumulated impairment losses thereon.”

“Carrying amount of a liability is the amount at which a liability is recognized in the statement of financial position.”

3.14 The amounts presented in an entity’s statement of financial position are carrying amounts. Carrying amount represents the amount recognized in the statement of financial position, after deducting any accumulated depreciation and accumulated impairment losses thereon. Therefore, the carrying amount of different items in the statement of financial position will reflect different measurement bases, such as fair value or cost less depreciation, etc. Because carrying amount is the amount presented in the statement of financial position it is not a measurement basis as such and so will be referred to as a measurement approach.

The Fresh Start Method

3.15 The premise of the fresh start method is that the resulting entity is a new entity (irrespective of whether a new entity is formed) and therefore its history commences on that date. The fresh start method requires all of the identifiable assets and liabilities of all the combining entities to be measured at fair value as at the date of the entity combination.

3.16 The fresh start method does not appear to be currently applied in any jurisdiction.

Summary

3.17 Table 3 below summaries the three methods of accounting.

⁹ IFRS 3, Basis for Conclusions paragraph BC32

Table 3: Summary of Methods of Accounting

	Purchase or Acquisition Method	Pooling Method	Fresh Start Method
Measurement Basis	Remeasures the newly controlled entity's or operation's identifiable assets and liabilities to fair value	No remeasurement, all of the combining entities or operations recognized assets and liabilities are recognized at carrying amount	Remeasures all the combining entities or operations identifiable assets and liabilities to fair value
Surplus or deficit in year of the entity combination	Acquirer's surplus or deficit plus newly controlled entity's or operation's surplus or deficit from date of acquisition is recognized in the Statement of Financial Performance	All the combining entities or operations surplus or deficit from beginning of reporting period is recognized in the Statement of Financial Performance	Surplus or deficit recognized in the Statement of Financial Performance commences from date of amalgamation
Accumulated surplus or deficit	Acquirer's accumulated surplus or deficit plus newly controlled entity's or operation's surplus or deficit from date of acquisition is recognized in net assets/equity	All the combining entities or operations accumulated surplus or deficit from beginning of reporting period is recognized in net assets/equity	Surplus or deficit commences from date of amalgamation, so accumulated surplus or deficit doesn't arise until the second reporting period
Comparatives in the year of the entity combination	Not restated	Restated	None
Consideration transferred	Can be cash or other assets including shares	Exchange of shares only	Can be cash or other assets including shares

Measurement Bases

3.18 This section of the CP briefly considers other measurement bases that could be applied to an entity combination, notwithstanding that the purchase or acquisition method, and fresh start method use fair values, and the pooling method uses carrying amounts because (1)

this CP looks at possible methods of accounting for ECUCC for which there is no accepted method of accounting internationally¹⁰, (2) many acquisitions which are ECNUCC do not involve the transfer of consideration, and (3) because it may be appropriate to use another measurement basis for private sector profit-oriented entities acquired during the global financial crisis.

Existing Requirements for Similar Transactions

- 3.19 Existing IPSASs use a number of different measurement bases for initial recognition and measurement of the acquisition of an asset or the assumption of a liability, dependent upon the type of asset or liability being measured, and with or without the transfer of consideration. These include (in no particular order):
- (a) Cost, e.g., investment property, property, plant, and equipment and intangible assets¹¹. The measurement of the initial cost of these assets where they are acquired through a non-exchange transaction is fair value at the date of acquisition¹²;
 - (b) Fair value, e.g., financial assets and financial liabilities¹³;
 - (c) Fair value less costs to sell, e.g., biological assets; and
 - (d) Best estimate of the expenditure required to settle a present obligation¹⁴.

Measurement Phase of the Conceptual Framework Project

- 3.20 The Consultation Paper, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements* (Measurement CP), discusses historical cost, market value, and replacement cost measurement bases. It also discusses the deprival value concept which does not describe a single measurement basis, but rather a means by which a basis be selected that is relevant to the circumstances. The Measurement CP considers that there is no single measurement basis that is appropriate in all circumstances¹⁵. To minimize the drawbacks of using different measurement bases, it considers that a particular basis is selected only where this is justified by economic circumstances¹⁶.

¹⁰ IFRS 3 excludes business combinations under common control from its scope.

¹¹ Investment property (IPSAS 16.26), property, plant, and equipment (IPSAS 17.26) and intangible assets (IPSAS 31.31)

¹² Investment property (IPSAS 16.27), property, plant, and equipment (IPSAS 17.27) and intangible assets (IPSAS 31.31)

¹³ Initial recognition of a financial asset or financial liability is at fair value, plus, in the case of a financial asset or financial liability not at fair value through surplus or deficit, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability (IPSAS 29.45)

¹⁴ Provisions (IPSAS 19.44) and liabilities in respect of the inflow of resources arising from a non-exchange transaction (IPSAS 23.57).

¹⁵ CF CP Measurement, paragraph 1.5.

¹⁶ CF CP Measurement, paragraph 1.6.

Possible Application of Other Measurement Bases to Entity Combinations

- 3.21 Other measurement bases that could be applied to an entity combination are cost and market value. Measurement bases that relate to subsequent measurement are not considered because it is the initial measurement of the transaction or other event that gives rise to an entity combination that is the scope of this CP.

Cost

- 3.22 For the purposes of this CP, the cost basis means the amount that an entity pays to acquire an asset. The cost basis can only be applied to acquisitions because amalgamations do not involve the transfer of consideration. If the cost basis is used for the measurement of an acquisition, the cost is the amount that the recipient pays to the transferor to gain control of a newly controlled entity or operation. In other words, the amount of the consideration transferred. Where no consideration is transferred, the recipient would not recognize the assets acquired or the liabilities assumed unless the total of the net assets acquired also equaled nil. Where consideration has been transferred, some basis is needed for determining the allocation of that cost to the assets acquired and liabilities assumed. The basis of allocation of cost may not reflect either the carrying amount or fair value of those assets and/or liabilities that are gained control of on the date of the acquisition.
- 3.23 One view is that cost does not provide useful information for accountability and decision-making purposes, because where no consideration is transferred and the recipient gains control of net assets, there is no recognition of these net assets in the recipient's statement of financial position. Where consideration is transferred, cost is unlikely to result in the recognition of amounts which reflect either the fair value or carrying amount of the net assets acquired.
- 3.24 Another view is that cost provides useful information for accountability and decision-making purposes because that is the amount the recipient incurred in acquiring a newly controlled entity or operation.

Potential Preliminary View:

[This PV has been included because the IPSASB agreed, at its June 2011 meeting, that the appropriate measurement basis or approach to use for acquisitions not under common control was fair value or carrying amount]

Cost does not provide useful information for accountability and decision-making purposes because it does not reflect the economic substance of the entity combination, i.e., the recipient has acquired net assets or assumed net liabilities as a result of the acquisition.

Market Value

- 3.25 Market value as a measurement basis is not separately considered as a measurement basis in the CP because market value is set within the context of fair value because fair value

will equal market value where a market exists for a particular asset. Where a market does not exist, then fair value is estimated.

4 Entity Combinations not under Common Control (ECNUCC): Acquisitions

Introduction

- 4.1 An acquisition takes place between entities not under common control where a recipient gains control of one or more entities and/or operations. It may occur as a result of the reallocation of responsibilities across different levels of government or as a result of a decision taken by government to acquire a private sector entity.
- 4.2 The IPSASB explored and discarded several ways of categorizing different types of acquisitions to see if there was a fundamental difference between them that could be used to help determine the measurement basis to use.
- 4.3 At the commencement of this project, the IPSASB considered that a distinction could be made between acquisitions arising from exchange transactions and acquisitions arising from non-exchange transactions. As already noted, the IPSASB based ED 41 (entity combinations from exchange transactions) on IFRS 3 but because that Standard includes requirements related to bargain purchases, the IPSASB encountered difficulties in clearly distinguishing between acquisitions arising from exchange transactions and acquisitions arising from non-exchange transactions. As a result, the IPSASB decided not to develop ED 41 into an IPSAS.
- 4.4 The IPSASB also considered an approach to determining which measurement basis or approach to use based on which sector the transferor belongs to, i.e., the public sector or the private sector. The IPSASB explored this approach and considered that it was problematic because the distinction between the two sectors is not always clear. Other approaches considered related to whether the acquisition was negotiated, consideration was transferred or the nature of the operation or activity changes. The IPSASB concluded that none of these possible approaches reflected a fundamental difference between different types of acquisitions. Thus, this CP does not distinguish between different types of acquisitions.
- 4.5 To assess the relative merits of carrying amount and fair value, the discussion below considers each in the context of the objectives of financial reporting and the qualitative characteristics proposed in CF-ED 1. CF-ED 1 proposes that the objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes. The qualitative characteristics of information included in general purpose financial reports of public sector entities are relevance, faithful representation, understandability, timeliness, comparability, and verifiability. The constraints on information are materiality, cost-benefit and the need to achieve an appropriate balance between the qualitative characteristics. Whilst there needs to be a balance between all qualitative characteristics, this CP focuses primarily on three qualitative characteristics: (1) relevance, (2) faithful representation, and (3) comparability, and the cost-benefit constraint.

What is the Appropriate Measurement Basis or Approach?

- 4.6 The IPSASB notes that IFRS 3 requires business combinations to be accounted for using the acquisition method whereby the acquirer recognizes and measures the identifiable assets and liabilities of the acquiree at fair value. Goodwill is measured indirectly as the difference between the consideration transferred in exchange for the acquiree's net identifiable assets and liabilities and non-controlling interests (if any). If that difference is negative because the value of the acquired identifiable assets and liabilities exceeds the consideration transferred, the acquirer recognizes a gain from a bargain purchase.
- 4.7 The IPSASB concur with the aspect of the acquirer recognizing the acquiree's assets and liabilities. However, because the public sector undertakes many acquisitions with the transfer of no or nominal consideration, this CP explores different measurement bases that could be applied to the recognition and initial measurement of the assets acquired and the liabilities assumed by the recipient instead of focusing only on fair value. It also explores the recognition and presentation of the difference arising from the net assets acquired or net liabilities assumed and the consideration transferred (if any).

Relevance

- 4.8 CF-ED 1 describes the qualitative characteristic of relevance as:

“Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. Financial and non-financial information is capable of making a difference when it has confirmatory value, predictive value, or both. It may be capable of making a difference, and thus be relevant, even if some users choose not to take advantage of it or are already aware of it.”¹⁷

- 4.9 One view is that carrying amount provides more relevant information to users than fair value because it focuses on the costs originally incurred to acquire the assets and liabilities. Thus, the subsequent performance of the recipient, i.e., its accountability for the management of these resources, is based on the carrying amount of the resources acquired in the original purchase of the assets less subsequent accumulated depreciation and accumulated impairment losses, rather than fair value.
- 4.10 Another view is that carrying amount provides less relevant information than fair value because the recipient is not held accountable for the current value of the resources acquired. This is because if the recipient had to buy the assets individually rather than acquire them in an acquisition they would be accounted for at cost, which is assumed to equal fair value at the date of acquisition in an exchange transaction. If the transaction to acquire an individual asset is a non-exchange transaction, IPSASs require the asset's cost to be its fair value at the date of acquisition.
- 4.11 Furthermore, where carrying amount is used, the information on the acquisition is incomplete and thus less relevant to users because only assets and liabilities recognized in

¹⁷ CF-ED 1, paragraph 3.6.

the newly controlled entity or operation's financial statements are recognized by the recipient, thereby potentially omitting some assets and liabilities.

- 4.12 Those who consider fair value provides more relevant information to users, believe that the assessment of subsequent performance more accurately reflects the recipient's management of the resources it gains control of as a result of the acquisition because applying fair value reflects the current value of those resources. In particular, the fair value of a cash-generating asset provides current information about the expected future cash flows that the asset will generate which enhances the predictive value of information. For non-cash-generating assets, fair value¹⁸ provides information useful to ascertaining the capacity of such assets for future service delivery activities.
- 4.13 In addition, fair value provides a more complete picture of the acquisition because it recognizes the identifiable assets and liabilities of the newly controlled entity or operation regardless of whether they were recognized before the acquisition.

Faithful Representation

- 4.14 CF-ED 1 describes the qualitative characteristic of faithful representation as:

“To be useful in financial reporting, information must be a faithful representation of the economic and other phenomena that it purports to represent. Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error. Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance—which is not necessarily always the same as its legal form.”¹⁹

- 4.15 One view is that carrying amount is a faithful representation of the resources the recipient acquires because it generally reflects the resources expended to obtain those assets less subsequent accumulated depreciation and accumulated impairment losses, before the date of the acquisition. Therefore, carrying amount is a faithful representation of the resources the recipient gains control of in an acquisition on an historical cost basis. Carrying amount has a high degree of verifiability because the amounts are known and are readily available and so helps assure users that information faithfully represents the phenomena that it purports to represent.
- 4.16 Another view is that using carrying amount may result in the recognition of assets and liabilities at amounts which may be overstated or understated in relation to their fair values. The result is that some of the gains or losses subsequently recognized by the recipient would actually have been generated or incurred before the acquisition takes place. Those of this view consider that using carrying amount is not a faithful representation of the resources the recipient gains control of in an acquisition.

¹⁸ IPSAS 17, *Property, Plant, and Equipment* includes guidance on how to estimate fair value where there is no market value for that type of asset.

¹⁹ CF-ED 1, paragraph 3.10.

- 4.17 Furthermore, using carrying amount may provide information that is incomplete and so not faithfully representative because not all of the assets and liabilities of the newly controlled entity or operation may have been recognized.
- 4.18 Those of the view that using carrying amount is not a faithful representation of the resources the recipient gains control of in an acquisition, consider fair value is a faithful representation of the economic benefits and service potential that a recipient can expect to obtain from its acquisition of the newly controlled entity or operation.
- 4.19 However, those who do not accept the above argument question whether it is possible to ascertain fair value for some types of assets, i.e., is the amount recognized using fair value a faithful representation? This is a particular problem in the public sector where many entities have specialized assets for which there is an absence of a deep and liquid market. Additionally, the price may reflect the likelihood that a purchaser may have to adapt an asset before it is usable.

Comparability

- 4.20 CF-ED 1 describes the qualitative characteristic of comparability as:

“Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena. Comparability is not a quality of an individual item of information, but rather a quality of the relationship between two or more items of information.”²⁰

- 4.21 One view is that carrying amount enhances comparability by retaining the values of the recognized assets and liabilities in the newly controlled entity or operation from before the acquisition. The performance of the newly controlled entity or operation before and after the acquisition may then be compared without adjusting for a change in measurement basis and allows users to better assess trends and directions related to the entity’s performance.
- 4.22 Another view is that using fair value is consistent with the accounting treatment of the acquisition of individual assets because the cost of individual assets at the date of acquisition usually equals fair value²¹. It therefore using fair value enhances comparability between acquisitions of individual assets and acquisitions of entities or operations that have similar assets because the measurement method is the same irrespective of the means by which those assets and liabilities are obtained.

Cost-Benefit Constraint

- 4.23 CF-ED 1 describes the cost-benefit constraint as:

“Financial reporting imposes costs. The benefits of financial reporting should justify those costs. Assessing whether the benefits of providing information justify the related costs is often a matter of judgment, because it is often not possible to

²⁰ CF-ED 1, paragraph 3.21.

²¹ Note that the cost or consideration transferred (if any) by the recipient to the transferor in an acquisition does not usually equal either the fair value or the carrying amount of the net assets acquired.

identify and/or quantify all the costs or benefits of information included in GPFRs.”²²

- 4.24 Many are of the view that the carrying amount is almost always the least costly measurement approach to apply as it uses the existing carrying amount of the assets and liabilities of the newly controlled entity or operation and does not require identifying, measuring and recognizing assets or liabilities not previously recognized before the acquisition.
- 4.25 Where a newly controlled entity or operation has specialized assets for which there is an absence of a deep and liquid market, fair value would need to be estimated. Those of the view that carrying amount is almost always the least costly measurement approach to apply consider obtaining an estimate of fair value for specialized assets is a costly and time consuming process. Therefore, they would argue that where there is an absence of a deep and liquid market, the costs of determining fair value may be prohibitive and outweigh the benefits to users of having this information.

What is the Appropriate Accounting Treatment of the Difference Arising from the Net Assets Acquired or Net Liabilities Assumed and the Consideration Transferred (if any) in the Recipient’s Financial Statements?

- 4.26 The purchase or acquisition method was primarily developed for profit-oriented entities and requires any residual between the fair value of the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree, and the consideration transferred, to be recognized as goodwill. Because of the focus on profit-oriented entities, there are only rare instances where the difference is negative because the value of the acquired identifiable assets and liabilities exceeds the consideration transferred and in this situation the acquirer recognizes a gain from a bargain purchase.
- 4.27 Many acquisitions in the public sector take place with the transfer of no or nominal consideration and therefore the likelihood of the difference being negative are much higher.
- 4.28 In the recipient’s financial statements, the identifiable assets acquired and liabilities assumed in an acquisition are recognized where fair value is used as a measurement basis. Where carrying amount is the measurement approach adopted, a recipient recognizes the assets acquired and liabilities assumed that are recognized in the newly controlled entity or operation’s financial statements. This section of the CP explores possible accounting treatments of the difference arising from the net assets acquired or net liabilities assumed and the consideration transferred (if any).
- 4.29 The amount of the difference arising will be dependent on the measurement basis or approach adopted. When comparing carrying amount and fair value it is likely that the amount of the difference arising will be greater where fair value is adopted as a measurement basis. Another factor which may affect the difference arising is whether the recipient transfers consideration to the transferor.

²² CF-ED 1, paragraph 3.34.

4.30 The difference arising is calculated as the difference between:

- (a) The net assets acquired or the net liabilities assumed (the magnitude of this amount will differ depending upon the measurement basis or approach chosen); plus
- (b) The amount of any minority interest in the newly controlled entity; and
- (c) The consideration transferred (if any).

4.31 The amount of consideration transferred has an effect on the difference arising in the following ways:

- (a) Where no consideration is transferred and the recipient acquires net assets, the difference arising is a credit.
- (b) Where the consideration transferred is an amount less than the amount of the net assets acquired by the recipient, the amount of consideration transferred reduces the amount of the credit.
- (c) Where the consideration transferred equals the net assets acquired by the recipient, then there is no difference arising.
- (d) Where the consideration transferred is in excess of the net assets acquired by the recipient, the difference arising is a debit.

These situations are explored in further detail below.

Consideration Transferred (if any)

4.32 Consideration transferred occurs where a recipient transfers cash or other assets to the transferor. Consideration transferred can also include liabilities assumed by the recipient. In rare circumstances, consideration transferred may also include equity interests issued by the recipient.

Accounting Treatment of Difference Arising Where the Recipient Acquires Net Assets in Excess of Consideration Transferred (if any)

4.33 Where the recipient acquires net assets and (1) no consideration is transferred, or (2) consideration transferred is an amount less than the amount of the net assets acquired, the difference arising will result in an increase in the net assets/equity in the financial statements of the recipient. The recipient has an economic gain or an increase in service potential by the acquisition of an entity or operation from the transferor. Therefore, to be a faithful representation, the difference arising should be recognized as a gain²³ in surplus or deficit (in the statement of financial performance) in the reporting period in which it

²³ The IPSASB considered whether the term “revenue” should be used. However, the definition of revenue refers to a “gross inflow” whereas the difference arising as the result of an acquisition is a net amount and therefore the term “gain” is used. This parallels the treatment of the disposal of property, plant, and equipment in IPSAS 17, *Property, Plant, and Equipment* where the gain or loss arising from the derecognition of an item of property, plant, and equipment shall be included in surplus or deficit when the item is derecognized (IPSAS 17.83).

occurs. This information is relevant to users as it reflects the value of the acquisition to the recipient.

- 4.34 The IPSASB notes that this treatment of the difference arising as a gain is consistent with the requirement in IFRS 3 with the treatment of a gain arising from a bargain purchase.

Accounting Treatment of Difference Arising Where Consideration Transferred is in Excess of Net Assets Acquired

- 4.35 Where the consideration transferred is in excess of the net assets acquired, the difference arising is a debit. The debit could be recognized as:

- (a) A loss²⁴ in surplus or deficit (in the statement of financial performance); or
- (b) Goodwill (in the statement of financial position).

- 4.36 Existing IPSASs do not include a definition of goodwill or any requirements for its recognition and measurement. In the IASB's literature, IFRS 3 defines goodwill as:

“An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized.”

- 4.37 The IPSASB's current definition of an asset is²⁵:

“Assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.”

- 4.38 The issue here is then: where a debit does arise, does it meet the definition of an asset? The recipient has gained control of an entity or operation as a result of a past event, i.e., the transaction or other event giving rise to the acquisition. The recipient recognizes an increase in net assets and the consideration transferred to the transferor is in excess of this amount, so there may be unidentified assets that have not been separately recognized.

- 4.39 One view is that where the assets of a newly controlled entity or operation are held primarily to provide service potential rather than economic benefits (non-cash-generating assets), service potential not directly related to a recognized asset, cannot arise. So, a debit would not meet the definition of an asset and would therefore simply be an overpayment and should be recognized as a loss in surplus or deficit (in the statement of financial performance) in the reporting period in which it occurs. This information is relevant to users because it reflects the view that the recipient overpaid for the acquisition and this information will be useful for accountability and decision-making purposes. The overpayment demonstrates that the recipient expended more resources to acquire the

²⁴ Similar to the reasoning for the use of the term “gain” instead of the term “revenue” above, the term “loss” is used rather than the term “expense.”

²⁵ In December 2010, the IPSASB issued a Consultation Paper, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements* (CF-CP 2). The result of this project may change the definition of an asset.

newly controlled entity or operation than is reflected in the amount of net assets acquired and is therefore a faithful representation.

- 4.40 This view is consistent with the IPSASB's conclusions in IPSAS 21, *Impairment of Non-Cash-Generating Assets* that it is possible to identify the service potential of individual assets so the creation of a service-generating unit (by analogy from IAS 36, *Impairment of Assets*, cash-generating unit) is unnecessary. IPSAS 21 requires impairment testing on individual non-cash-generating assets.
- 4.41 However, where the assets of a newly controlled entity or operation are held primarily to provide economic benefits (cash-generating assets), i.e., provide a return on investment similar to a profit-oriented entity, there can be assets that are not separately identifiable and therefore are unable to be separately recognized. The difference arising in this instance would meet the definition of an asset and could be recognized as goodwill (in the statement of financial position). This information is relevant to users as it reflects that the recipient has acquired more assets than can be separately identified and recognized.
- 4.42 This is consistent with the IPSASB's conclusions in IPSAS 26, *Impairment of Cash-Generating Assets* where it is not possible to estimate the recoverable amount of an asset with an indication of impairment, the recoverable amount is determined on the cash-generating unit to which the asset belongs. This view is also consistent with the requirements in IFRS 3 that a debit meets the definition of an asset and is therefore recognized as goodwill.
- 4.43 Others argue that it does not matter whether the newly controlled entity or operation has cash-generating or non-cash-generating assets and consider a debit arising from an acquisition by a public sector entity does not meet the definition of an asset and is simply an overpayment. The debit should therefore be recognized as a loss in surplus or deficit (in the statement of financial performance) in the reporting period in which it occurs.

Accounting Treatment of Difference Arising Where the Recipient Assumes Net Liabilities

- 4.44 Where the recipient assumes net liabilities, the difference arising will result in a decrease in net assets/equity in the financial statements of the recipient. In other words, the recipient has assumed an economic loss by the acquisition of an entity or operation from the transferor – the amount of that loss will be greater in the unlikely event that any consideration is transferred by the recipient. This decrease in net assets/equity should be recognized as a loss in surplus or deficit (in the statement of financial performance) in the reporting period in which it occurs. This information is relevant to users as it reflects the effect of this transaction or other event on the recipient.

Summary

- 4.45 Where the amount of consideration transferred exceeds the net assets acquired, there are choices as to where that amount could be recognized. The paragraphs above set out the following views:
- (a) Where a newly controlled entity or operation has non-cash-generating assets the difference should be recognized as a loss in surplus or deficit (in the statement of

financial performance) and where a newly controlled entity or operation has cash-generating assets the difference should be recognized as goodwill (in the statement of financial position); or

- (b) The difference should be recognized as a loss in surplus or deficit (in the statement of financial performance).

4.46 In addition, to these options, preparers could be given a free choice of where to recognize the difference arising or a set of condition-based criteria could be developed to determine whether the amount of consideration transferred exceeds the net assets acquired meets the definition of an asset and is therefore recognized as goodwill (in the statement of financial position).

4.47 Table 4 below sets out where the difference arising could be recognized, broken down by the amount of consideration transferred.

Table 4: Treatment of Difference Arising

Consideration Transferred	Treatment of Difference Arising	
	Recipient Acquires Net Assets	Recipient Assumes Net Liabilities
No/nominal	Gain	Loss
Less than net assets acquired	Gain	–
Amount equaling NA	–	–
Amount in excess of NA/NL	1 Loss for non-cash-generating assets and goodwill for cash-generating assets 2 Loss only 3 Free choice of loss or goodwill 4 Condition-based criteria for loss or goodwill	Loss

Summary

4.48 The purchase or acquisition method requires the measurement basis to be fair value. This CP assesses the relative merits of carrying amount and fair value for potential application using the purchase or acquisition method because public sector entities undertake many acquisitions with the transfer of no or nominal consideration.

- 4.49 In addition, where the amount of consideration transferred exceeds the net assets acquired, the purchase or acquisition method requires the difference to be recognized as goodwill. This CP assesses whether the excess of consideration transferred over the net assets acquired should be recognized as a loss or goodwill.
- 4.50 The IPSASB notes that the service potential or future cash flows directly related to the newly controlled entity or operation will usually be the same irrespective of the measurement basis or approach chosen to recognize its assets and liabilities. However, the financial performance of that acquisition in the financial statements of the recipient will vary depending on the measurement basis or approach applied. If preparers are given a free choice of measurement basis or approach this would reduce comparability between entities and over time.
- 4.51 The IPSASB has not come to a preliminary view on either (1) the measurement basis or approach to use and (2) where to recognize the difference arising where the amount of consideration transferred exceeds the net assets acquired. The IPSASB seeks the feedback of constituents on these items.

Other Issues

- 4.52 The purpose of this section is to briefly explore the following issues:
- (a) Whether acquisitions of entities in financial distress, such as acquisitions related to the global financial crisis, should be accounted for differently than other acquisitions. In particular, whether there is a more appropriate measurement basis for recognizing that newly controlled entity or operation;
 - (b) Issues related to the acquisition of a joint venture where it also meets the definition of an entity combination;
 - (c) Issues related to the presence of minority interests; and
 - (d) Issues related to acquisition-related costs.

Acquisitions of Entities in Financial Distress

- 4.53 Some interventions in the global financial crisis have involved acquisitions of entities or operations, where, for example, a government provided funds to “bail out” a number of private sector banks and other private sector entities and, as a result, gained control of those entities. Effectively, the government undertook these acquisitions in its role of lender or guarantor of last resort. As a result, some of these formerly private sector entities are now controlled by a government. In many instances, the public sector entity that controls these newly controlled entities or operations intends to sell them once they are not in financial distress and can once again access the markets; however, this intention may take some years to be realized.
- 4.54 While such acquisitions have been a feature of the global financial crisis, they are not unique to that environment. There may be other circumstances whereby, because of strategic significance of the entity, or to protect affected third-parties, governments take control of an entity in financial distress.

- 4.55 If the assets and liabilities of the newly controlled entity or operation are valued at fair value, this value reflects the market value, if there is a market. However, one of the reasons that a government is acquiring the entity in financial distress may be due to there being no market. In this instance fair value would need to be estimated. In calculating this value, it may be a higher amount for a government because a government may place a lower weight on liquidity risk than private sector entities. If the assets are in fact more valuable because they are held by a government, this suggests that an entity-specific value which is not fair value could be used to reflect that. Note that this does not assume the subsequent performance of the distressed assets (i.e., the expected cash flows) is changed because of a government controlling the entity, but rather because a government is more able to withstand volatility in cash flows, the risk assumptions it uses in discounting such cash flows might be less onerous than other market participants would apply.
- 4.56 Another issue with a government acquiring entities in financial distress is that the consideration transferred (if any) may not reflect the fair value of the entity or operation acquired. For example, a government may gain control of an insurance entity where the liabilities assumed exceed the value of the assets acquired, for nil consideration. In such a case it would not be appropriate to recognize goodwill on acquisition as an asset, when the government has effectively incurred an expense by providing a benefit to the policyholders.
- 4.57 Issues relating to whether such acquisitions of entities in financial distress where the intention of the government is to sell them once they are not in financial distress, should be consolidated on a line-by-line basis in the financial statements of the recipient are outside the scope of this CP. The IPSASB is currently undertaking a project to revise its consolidation and related standards²⁶ and this issue is within the scope of that project.

Acquisition of a Joint Venture where it also Meets the Definition of an Entity Combination

- 4.58 Where the acquisition of a joint venture also meets the definition of an acquisition, the venturer could apply similar accounting to that discussed above. The measurement basis or approach, i.e., fair value or carrying amount could be applied to the venturer's share of the assets and liabilities of the joint venture. The presentation of assets and liabilities will differ according to the type of joint venture in accordance with IPSAS 8. For example, where it is the acquisition of a jointly controlled entity, the venturer will recognize its share of the net assets. Where it is a jointly controlled operation, the venturer will recognize the assets it controls and the liabilities it has assumed.
- 4.59 Where the venturer acquires net assets and (1) no consideration is transferred, or (2) consideration transferred is an amount less than the amount of the net assets acquired the difference arising is recognized as a gain in surplus or deficit (in the statement of financial performance). Where the consideration transferred is in excess of the net assets acquired, the difference arising would either be a recognized as a loss in surplus or deficit (in the statement of financial performance) or goodwill (in the statement of financial

²⁶ Revision of IPSASs 6–8

position). Where the venturer assumes net liabilities, the difference arising is recognized as a loss in surplus or deficit (in the statement of financial performance).

Potential Preliminary View:

[This PV has been included because the IPSASB agreed, at its September 2011 meeting, that the project should include requirements related to the acquisition of a joint venture where it also meets the definition of an entity combination]

The accounting treatment of an acquisition should be applied to the acquisition of a joint venture where it meets the definition of an entity combination.

Presence of Minority Interests

4.60 The discussion above does not consider an acquisition where less than 100% of the ownership interest is obtained by the recipient, except where the presence of a minority interest effects the calculation of the difference arising. This section of the CP considers situations where a recipient gains control of less than 100% of the newly controlled entity or operation. The portion that does not relate to the controlling entity is termed a “minority interest.” The *Glossary of Defined Terms* defines minority interest as:

“That portion of the surplus or deficit and net assets/equity of a controlled entity attributable to net assets/equity interests that are not owned, directly or indirectly, through controlled entities, by the controlling entity.”

Measurement of a Minority Interest

4.61 A minority interest can be measured at either:

- (a) Fair value; or
- (b) The minority interest’s proportionate share of the newly controlled entity or operation’s net assets.

4.62 Where a newly controlled entity or operation is listed on a stock exchange, fair value will be based on active market prices for the equity shares not held by the recipient. Where it is not listed, fair value will need to be estimated using a valuation technique.

4.63 Many acquisitions in the public sector do not involve the transfer of consideration, and, except in rare circumstances newly controlled entity or operation will not be listed on a stock exchange. Thus, fair value would need to be estimated.

Potential Preliminary View:

[This PV has been included because the IPSASB agreed, at its September 2011 meeting, that the measurement of a minority interest should be the minority interest’s proportionate share of the newly controlled entity’s or operation’s net assets]

A minority interest should be measured as a proportionate share of the newly controlled entity or operation’s net assets.

- 4.64 The IPSASB notes that, in IFRS 3, acquirers' have an option to choose whether to value non-controlling interests (formerly called minority interests) at fair value or as a proportionate share of the acquiree's net assets.

Effect of a Minority Interest on the Difference Arising

- 4.65 Where the recipient acquires net assets and (1) no consideration is transferred, or (2) consideration transferred is an amount less than the amount of the net assets acquired, the presence of a minority interest has the effect of decreasing the amount of the gain recognized. Where the consideration transferred is in excess of the net assets acquired, a minority interest increases the amount of difference arising²⁷. Where the recipient assumes net liabilities, the presence of a minority interest has the effect of decreasing the amount of the loss recognized.

Acquisition-Related Costs

- 4.66 Acquisition-related costs are the costs a recipient incurs to effect the acquisition. Examples of acquisition-related costs include legal, accounting valuation and other professional and consulting fees, and costs to issue debt or equity securities.
- 4.67 Existing IPSASs for non-financial assets use a cost accumulation approach for the measurement on initial recognition of an asset from an exchange transaction. Therefore, the initial cost of an asset is its purchase price, plus any directly attributable costs²⁸. The measurement on initial recognition of an asset from a non-exchange transaction is fair value at the date of acquisition. For these types of acquisition, IPSASs are silent as to what to do with acquisition-related costs.
- 4.68 Existing IPSASs for financial assets require the measurement on initial recognition at fair value, plus, in the case of a financial asset not at fair value through surplus or deficit, transaction costs that are directly attributable to the acquisition of the financial asset.
- 4.69 In Section 3, the IPSASB has a preliminary view that the cost basis is not an appropriate measurement basis to use because it does not provide useful information to users. Consequently, a cost accumulation basis cannot be used for acquisition-related costs for an acquisition of a newly controlled entity or operation. Therefore, do acquisition-related costs meet the definition of an asset? Paragraph 4.37 sets out the definition of an asset.
- 4.70 One view is that acquisition-related costs are not part of the acquisition of the newly controlled entity or operation because they are not transactions between the recipient and transferor. Rather they are transactions between the recipient and other third-parties for services received. These costs are not assets at the date of acquisition because the benefits have already flowed to the recipient from the services received. Those of this view consider acquisition-related costs should be an expense in the statement of financial

²⁷ Paragraphs 4.35–4.43 discuss whether the difference arising in this situation is a loss recognized in surplus and deficit in the statement of financial performance or goodwill recognized in the statement of financial position.

²⁸ Investment property (IPSAS 16.28), property, plant, and equipment (IPSAS 17.30), and intangible assets (IPSAS 31.34)

performance in the period in the period in which the services are received. Where costs are directly related to the issue of debt or equity instruments they should be recognized in accordance with IPSAS 29, *Financial Instruments: Recognition and Measurement*.

- 4.71 This view is similar to that applied in IFRS 3, which requires that the costs incurred by an acquirer to effect a business combination to be accounted for as expenses in the period in which the costs are incurred and services are received except for the costs related to the issue of debt or equity securities which are accounted for in accordance with IAS 32, *Financial Instruments: Presentation* and IAS 39, *Financial Instruments: Recognition and Measurement*²⁹.
- 4.72 Another view is that acquisition-related costs meet the definition of an asset because they are directly attributable to the acquisition of the newly controlled entity or operation. That the cost basis is not used for the measurement basis for the newly controlled entity or operation's assets and liabilities is not relevant. Rather what is relevant is that future economic benefits or service potential are expected to flow to the recipient from its acquisition of the newly controlled entity or operation. Those of this view consider acquisition-related costs should be recognized as an asset in the statement of financial position.

²⁹ IFRS 3, paragraph 53

5. Entity Combinations not under Common Control (ECNUCC): Amalgamations

Introduction

- 5.1 An amalgamation takes place between entities not under common control where two or more entities and/or operations agree to combine and none of the combining entities or operations gain control over the other entities or operations. In other words, no acquirer can be identified.
- 5.2 The structure of an amalgamation can differ dependent on factors, such as legislative requirements. And an amalgamation may or may not involve the use of a new entity as the resulting entity.
- 5.3 An amalgamation may be imposed by a higher level of government to be a cost-effective and efficient provision of public services even though the higher level of government does not control the lower level of government. An amalgamation may also be undertaken voluntarily so that the combining entities are able to maintain the current level of services.

How to determine the Boundary between Acquisitions and Amalgamations

- 5.4 In order for a business combination to qualify as a uniting of interests, IAS 22 required that the definition of a uniting of interests was met, i.e., an acquirer could not be identified. In addition, three criteria had to be satisfied. The three criteria are (1) the exchange or pooling of the substantial majority of the voting common shares of the combining entities, (2) the relative equality in fair values of the combining entities and (3) the continuance of substantially the same percentage in voting rights and interest of the shareholders of each combining entity in the combined entity.
- 5.5 In assessing whether these criteria could be applied to amalgamations in the public sector, it is immediately apparent that criteria (1) and (3) relate to ownership interests which public sector entities do not usually have³⁰. These criteria also include the notion of an exchange of approximately equal values so that the shareholders of the combining entities retain a modified ownership interest in the combined entity which has approximately the same value as the value in the shareholding of one of the combining entities. The purpose of a uniting of interests for profit-oriented entities, it is to improve the return on investment to shareholders.
- 5.6 An amalgamation in the public sector takes place to improve the effectiveness and efficiency of public services. There are usually no ownership interests (as that term is used for financial reporting purposes) and no exchange of consideration. Therefore, criteria (1) and (3) above do not appear relevant. Criterion (2) is discussed below.

³⁰ Phase 2 of the Conceptual Framework project is considering the issue of ownership interests and how they relate to public sector entities.

Does the Relative Size of the Combining Entities Matter?

- 5.7 Criteria (2) in IAS 22 required the fair values of the combining entities be relatively equal. This is due to the fact that if the combining entities are of a disparate size, an acquirer could be identified, i.e., the larger of the combining entities. Does this reasoning apply in the public sector? Where an amalgamation is directed by a higher level of government say, by the enactment of legislation because it does not control the lower level of government, it would seem that the relative size of the combining entities has little to do with the actions or intent of the combining entities and thus such a factor is unlikely to be relevant in identifying an acquirer. It may be that one of the factors to consider when assessing whether a transaction or other event meets the definition of an amalgamation is whether it is directed by a higher level of government.

Boundary between an Acquisition and an Amalgamation

- 5.8 To determine the boundary between an acquisition and an amalgamation, firstly the definition of an amalgamation needs to be met. Section 2 defines an amalgamation as:

“A transaction or other event where two or more entities and/or operations combine and none of the combining entities and/or operations gain control of the other entities and/or operations.”

- 5.9 The distinguishing feature of this definition is that in an amalgamation an acquirer cannot be identified.
- 5.10 To help identify an amalgamation, other factors relating to the facts and circumstance surrounding the transaction or other event should be explained. It remains to be determined whether these factors should be additional criteria that must be met, in addition to meeting the definition of an amalgamation, or whether they are simply used to help in making the decision on whether an acquirer can be identified.

Does the transfer of consideration matter?

- 5.11 Another factor that could be considered is whether the transaction or other event includes the transfer of consideration. Consideration is usually transferred (an amount paid in cash or other assets) to reimburse the former owners of an entity for their loss of control of that entity. A lack of consideration may indicate that there is no acquirer. It may be that another factor to consider when assessing whether a transaction or other event meets the definition of an amalgamation is the absence of consideration.

What is the Appropriate Method?

- 5.12 Section 3 of this CP sets out two methods of accounting for amalgamations. They are: the pooling method and the fresh start method. The use of carrying amount or fair value as a measurement approach or basis, respectively, are not separately discussed because the pooling method uses carrying amount and the fresh start method uses fair value.
- 5.13 Under the pooling method, the assets, liabilities and net assets/equity of the combining entities or operations for the period in which the combination occurs and for any comparative periods disclosed, are included in the financial statements of the resulting

entity as if they had been combined from the beginning of the earliest period presented. Under the fresh start method, the resulting entity is considered to be a new entity, with all of its assets and liabilities being measured at fair value as at the date of the entity combination and therefore its history commences on that date.

- 5.14 Whilst the discussion below assesses both methods against some of the qualitative characteristics of financial reporting, it may be that one of these methods is modified to be appropriate for the public sector.

Relevance

- 5.15 Paragraph 4.8 describes the qualitative characteristic of relevance.
- 5.16 One view is that the pooling method provides more relevant information to users than the fresh start method because it uses the carrying amount to recognize assets and liabilities. Thus, the amounts are connected to the original resources expended to obtain those assets less subsequent accumulated depreciation and accumulated impairment losses, rather than the resulting entity recognizing a value that is not based on the expenditure of resources. The resulting entity is accountable for its performance based on the carrying amount of those assets.
- 5.17 In addition, the pooling method provides better confirmatory and predictive values because the history of all of the combining entities or operations is kept by combining the surplus or deficit of the combining entities, thereby enhancing relevance. Therefore, supporters of this view do not believe the premise on which fresh start accounting is built, that the resulting entity is a new entity with no history.
- 5.18 Another view is that the pooling method provides less relevant information to users than the fresh start method because the resulting entity is not held accountable for the current value of resources because they assume carrying amount will be less than fair value, thereby the resulting entity recognizes the resources at a discount. Thus the resulting entity is not accountable for the full value of the resources available. Supporters of this view note that:
- (a) Where the pooling method is used, the information on the amalgamation is incomplete and thus less relevant to users because only assets and liabilities recognized in combining entities or operations financial statements are recognized by the resulting entity, thereby potentially omitting recognition of some assets and liabilities. They consider the fresh start method provides a more complete picture of the amalgamation than the pooling method by virtue of recognizing all of the identifiable assets and liabilities of the combining entities or operations regardless of whether those assets and liabilities were recognized before the amalgamation.
 - (b) Fresh start accounting provides information about the current value of resources by applying fair value. This enables users to assess the performance of the resulting entity based upon the current value of resources therefore enhancing the predictive value of information for cash-generating assets and information useful to ascertaining the capacity of non-cash-generating assets for future service delivery activities.

Faithful Representation

- 5.19 Paragraph 4.14 describes the qualitative characteristic of faithful representation.
- 5.20 One view is that the pooling method is a faithful representation of the resources available to the resulting entity because it generally reflects the resources expended to obtain those assets less subsequent accumulated depreciation and accumulated impairment losses, before the date of the amalgamation. Therefore, using the pooling method is a faithful representation of the resources available to the resulting entity on an historical cost basis. The pooling method uses carrying amounts which have a high degree of verifiability because the amounts are known and are readily available from the combining entities or operations financial statements. This helps assure users that information faithfully represents the phenomena that it purports to represent.
- 5.21 Additional factors that contribute to the pooling method being appropriate are that (1) there is no relative change in the use of assets, and (2) the majority of amalgamations in the public sector are not market-based transactions and thus, there is no need to change their valuation.
- 5.22 Another view is that the pooling method may result in the recognition of assets and liabilities in the resulting entity's financial statements at amounts which may be overstated or understated in relation to their fair values. The result is that some of the gains or losses subsequently recognized by the resulting entity would actually have been generated or incurred before the amalgamation takes place. The pooling method may also provide information that is incomplete and so not faithfully representative because not all of the assets and liabilities of the combining entities or operations may have been recognized.
- 5.23 Those of the view that using the pooling method is not a faithful representation of the resources available to the resulting entity, consider the fresh start method to be a faithful representation of the economic benefits and service potential that a resulting entity can expect to obtain from the resources available to it.
- 5.24 Furthermore, using the fresh start method provides more complete information, thereby enhancing faithful representation because it recognizes all assets and liabilities of the combining entities or operations, whether or not they were recognized before the amalgamation. Therefore, the fresh start method more faithfully reflects the value of the resources that are available to the resulting entity.
- 5.25 However, those who do not accept the fresh start method's use of fair value question whether it is possible to ascertain fair value for some types of assets, i.e., is the amount recognized using fair value a faithful representation? This is a particular problem in the public sector where for many assets there is an absence of a deep and liquid market.
- 5.26 Those who support the fresh start method consider that this method is, to a large extent, an extension of the use of fair value in the purchase or acquisition method of accounting for business combinations, where the acquirer uses fair values to recognize and measure the identifiable assets and liabilities it gains control of. As a result, many of the issues that may arise regarding the recognition and measurement of items have already been addressed. The fact that the purchase or acquisition method has been applied for many

years means that that experience should overcome most concerns about the faithful representation of the information produced by the use of the fresh start method.

Comparability

- 5.27 Paragraph 4.20 describes the qualitative characteristic of comparability.
- 5.28 One view is that the pooling method enhances comparability by retaining the values of the recognized assets and liabilities of the combining entities or operations in the resulting entity from before the amalgamation. It is easier for users to compare the performance of the resulting entity against the performance of the combining entities or operations financial statements without adjusting for a change in measurement basis and allows users to better assess trends and directions related to the resulting entity's performance.
- 5.29 Moreover, the pooling method's combining of the surplus or deficit of the combining entities or operations for the entire year, in the year of the amalgamation and for any prior years' presented, maintains and enhances the comparability with both prior year and future year results. Those who hold this view consider the fresh start method makes comparison over time difficult because users of the resulting entity's financial statements are unable to compare these financial statements with those of the combining entities or operations because no history is presented. Additionally, the values recognized are different from those used in the combining entities or operations financial statements and thus, it is difficult to determine trends.
- 5.30 Another view is that the fresh start method is comparable with a new entity starting anew and building up its assets and liabilities and so it is appropriate that the resulting entity commences from the date of the amalgamation. Those who hold this view consider that applying the fresh start method is consistent with the accounting treatment of the acquisition of individual assets and therefore the fresh start method enhances comparability because the measurement method is the same irrespective of the means by which those assets are obtained.

Cost-Benefit Constraint

- 5.34 Paragraph 4.23 describes the cost-benefit constraint.
- 5.35 Many are of the view that the pooling method is the least costly method to apply as it uses the existing carrying amounts of the assets and liabilities of the combining entities or operations and does not require identifying, measuring and recognizing assets or liabilities not previously recognized before the amalgamation. Those of this view consider that where the combining entities or operations have specialized assets for which there is an absence of a deep and liquid market, the fresh start method's requirement to use fair values would be a costly and time consuming exercise. These costs may be prohibitive and therefore outweigh the benefits to users of having this information.
- 5.36 Those who support the use of the fresh start method acknowledge that this approach would need to be further developed before it could be applied in practice. However, they consider most of the issues could be resolved by extending the guidance already available on the application of the purchase or acquisition method and thus would not be onerous.

Possible Modification to the Pooling Method

- 5.37 One of the requirements of the pooling method is that comparative information is restated as if the combining entities or operations had always been combined. One view of this requirement is that this information is clearly hypothetical and portrays a situation that did not actually exist. Those who agree with this view consider that the pooling method could be modified to omit this requirement and instead, require the resulting entity to combine the items in the statement of financial position as at the date of the amalgamation. They consider this to be representationally faithful because the combining entities and operations clearly did exist separately before the amalgamation. This would result in no comparatives being presented at the first reporting date. The surplus or deficit for the first reporting period would reflect only the performance of the resulting entity.
- 5.38 Those who consider that comparative information should not be restated acknowledge that the history of the combining entities or operations helps in assessing the performance of the resulting entity (see also paragraph 5.29). They consider that one method to ensure users can easily access this information is to require the presentation of “pro-forma” information on the combining entities’ or operations’ statements of financial performance before the amalgamation so that users can easily compare the financial performance of the resulting entity against that of the combining entities or operations.

Summary

- 5.39 The pooling method requires the resulting entity to recognize the existing financial statement items of the combining entities at carrying amount and requires restatement of comparative information as if they had been combined from the beginning of the earliest period presented. The fresh start method requires the resulting entity to recognize the identifiable assets and liabilities of the combining entities at fair value and the resulting entity commences from the date of the amalgamation.
- 5.40 The section above sets out a possible modification to the pooling method so that the resulting entity recognizes the financial statement items of the combining entities or operations at the date of the amalgamation, thereby commencing its history at this date.
- 5.41 The IPSASB notes that the future cash flows and service potential of the resulting entity will generally be the same regardless of which method is used to account for the amalgamation. However, the financial performance of the resulting entity varies significantly depending on the method applied. If preparers are given a free choice of method this would reduce comparability between entities and over time.

Potential Preliminary View:

[This PV has been included because the IPSASB agreed, at its June 2011 meeting, that carrying amount is the appropriate measurement approach to use for amalgamations]

The pooling method is preferable to the fresh start method at this time. The IPSASB acknowledges the fresh start method to have a conceptual advantage over the pooling method. However, the use of the fresh start method would be new to the IPSASB’s

constituents and the development of this method so that it can be applied in practice would be a major exercise. It is likely that a wide variety of implementation issues would arise that would need to be resolved before this method could be operationalized. In addition, it is likely that extensive implementation guidance would need to be developed to ensure the consistent application of this method.

Accounting Treatment in the Combining Entities or Operations

- 5.42 When the combining entities or operations apply accrual IPSASs, guidance is required as to how to apply IPSASs when an amalgamation is proposed. This guidance is necessary because the process to achieve an amalgamation may cover more than one reporting period. Although the combining entities or operations know they will be combined with other entities or operations sometime in the future, they still need to prepare financial statements until the date of the amalgamation. The issue here is then: should these financial statements be prepared on a going concern basis?
- 5.43 IPSAS 1³¹ requires that financial statements are prepared on a going concern basis unless there is an intention to liquidate the entity or to cease operating, or if there is no realistic alternative but to do so. The fact that the combining entities or operations will cease to exist on the date of the amalgamation may have an effect on the basis of preparation of the financial statements and may suggest that the financial statements should not be prepared on a going concern basis.
- 5.44 However, an alternative view is that a presumption could be made that the resulting entity will continue to undertake the same activities as the combining entities or operations because the resulting entity needs to fulfill the responsibilities it has assumed from the combining entities or operations. If that is the situation, then the combining entities or operations should continue to prepare their financial statements on a going concern basis, i.e., continue to measure assets and liabilities in accordance with applicable IPSASs, until the date of the amalgamation.

Potential Preliminary View:

[This PV has been included because the IPSASB agreed, at its June 2011 meeting, that the accounting treatment in the financial statements of the combining entities or operations should be prepared on a going concern basis]

Combining entities or operations should continue to prepare their financial statements on a going concern basis before the amalgamation takes place where the resulting entity will fulfil the responsibilities it has assumed from the combining entities or operations.

³¹ IPSAS 1, paragraph 38.

Examples of the Scope of this Consultation Paper

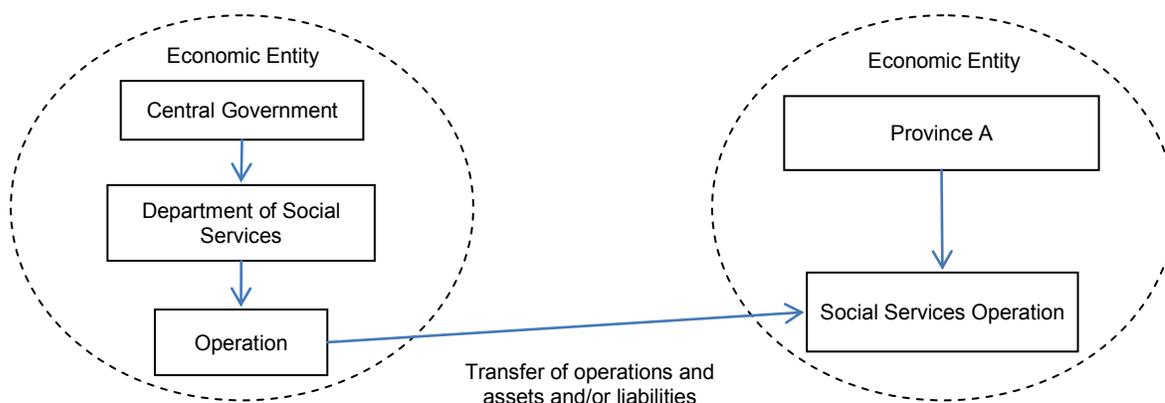
- A1. Set out below are examples of the types of transactions and other events that give rise to an entity combination which are included in this CP.

Entity Combinations not under Common Control

Acquisition

- A2. Where the recipient and transferor are not part of the same economic entity, the entity combination does not take place under common control. This CP includes in its scope the accounting treatment in the financial statements of the recipient, i.e., the entity that gains control of one or more entities and/or operations.
- A3. An acquisition not under common control can be illustrated as follows.

Diagram 1: Acquisition not under Common Control

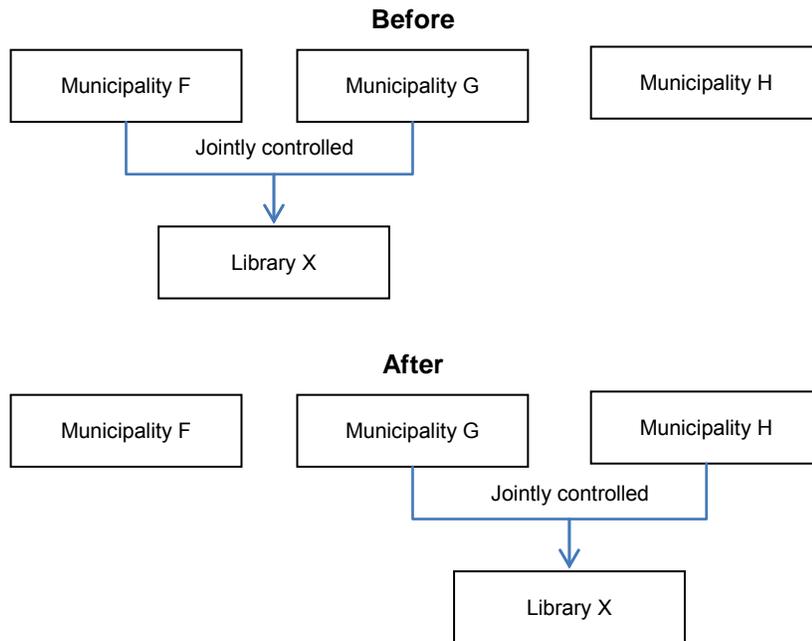


- A4. Diagram 1 illustrates an entity combination between entities that are not under common control. The Department of Social Services within the Central government transfers an operation to Province A, which is not controlled by the Federal government. Province A is the recipient and the Department of Social Services is the transferor.

Acquisition of a Joint Venture that also Meets the Definition of an Entity Combination not under Common Control

- A5. Where a venturer acquires a joint venture, this transaction or other event can also meet the definition of an entity combination. This can be illustrated as follows.

Diagram 2: Acquisition of a Joint Venture that also meets the Definition of an Entity Combination not under Common Control

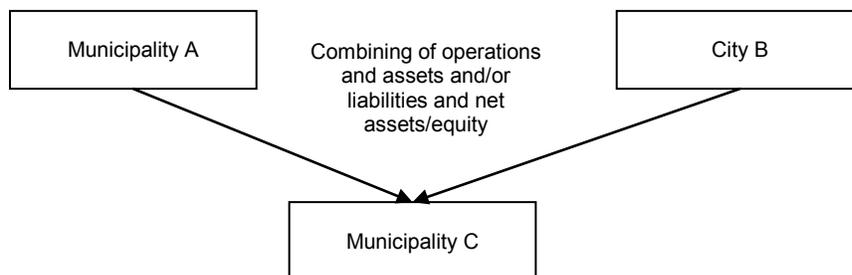


- A6. Diagram 2 illustrates the acquisition of a joint venture that also meets the definition of an entity combination between entities that are not under common control. Municipality H acquires Municipality F’s share of a joint venture, Library X.

Amalgamation

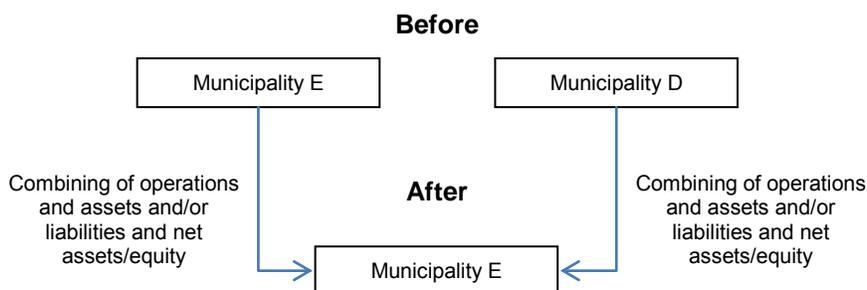
- A7. The transaction or other event that meets the definition of an amalgamation may take different forms and may or may not involve the formation of a new entity. These two situations can be illustrated as follows and assume that the local government is not under the control of the central or provincial government.

Diagram 3: Amalgamation using the Formation of New Entity



- A8. Diagram 3 above illustrates an amalgamation where Municipality C is formed to combine the operations, assets, liabilities and net assets/equity of Municipality A and City B. Municipality C is the resulting entity and Municipality A and City B are the combining entities. After the amalgamation, Municipality A and City B cease to exist.

Diagram 4: Amalgamation using an Existing Combining Entity



A9. Diagram 4 above illustrates an amalgamation where Municipality D and Municipality E combine together and they use the entity that is Municipality E before the amalgamation to hold the assets, liabilities and net assets/equity of the amalgamation. This amalgamation was forced upon Municipality D and Municipality E by the central government by the enactment of legislation because the central government in this jurisdiction does not control the local government. It was agreed that the name of the new municipality would be the same as one of the combining entities, so the resulting entity is named Municipality E. Municipality D and Municipality E before the amalgamation are the combining entities.

Entity Combinations under Common Control

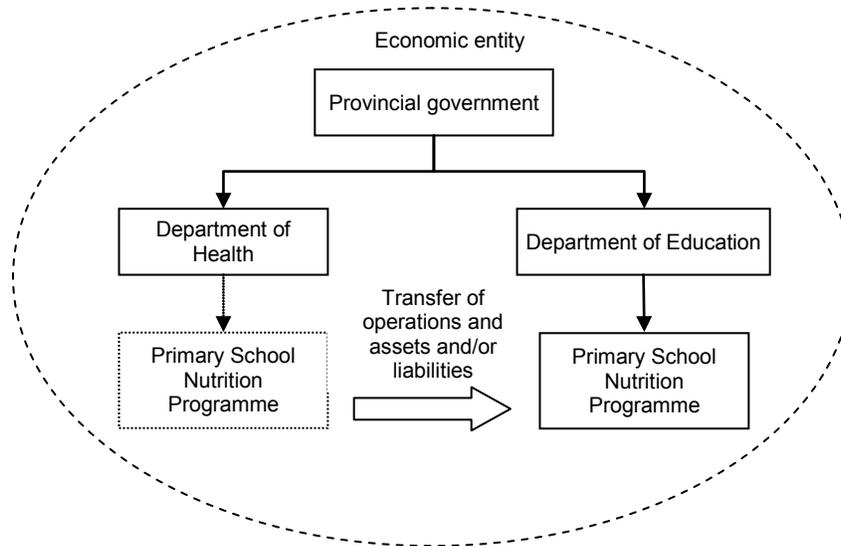
Acquisition

A10. An acquisition is a transaction or other event where one entity gains control of one or more entities and/or operations. Where the recipient and transferor are part of the same economic entity, the acquisition takes place under common control. This CP includes in its scope the accounting treatment in the financial statements of:

- (a) The recipient, i.e., the entity that gains control of one or more entities and/or operations; and
- (b) The transferor, i.e., the entity that loses control of one or more entities and/or operations.

A11. This can be illustrated as follows.

Diagram 5: Acquisition under Common Control

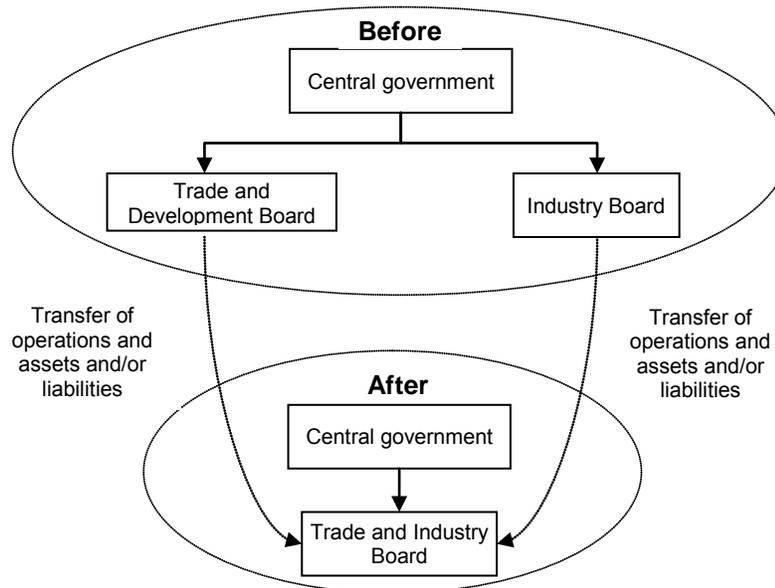


A12. Diagram 5 illustrates an acquisition between entities that are under common control. The Department of Education gains control of the Primary School Nutrition operation from the Department of Health. The Department of Education is the recipient and the Department of Health is the transferor.

Amalgamation

A13. An amalgamation may take place under common control as follows.

Diagram 6: An Amalgamation under Common Control



A14. Diagram 6 illustrates an amalgamation where a Central government restructures by transferring the Trade and Development Board and the Industry Board, both of which are

separate government operations and transferring the activities, assets and liabilities to a newly formed government operation, the Trade and Industry Board. The Trade and Development Board and the Industry Board are the combining operations and the Trade and Industry Board is the resulting operation.

Appendix B: Entity Combinations Flow Chart

