



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

529 Fifth Avenue, 6th Floor
New York, NY 10017
T +1 (212) 286-9344
F +1 (212) 286-9570
www.ifac.org

Agenda Item 2

Date: May 28, 2012
Memo to: Members of the IPSASB
From: Annette Davis
Subject: Draft Consultation Paper, *Public Sector Combinations*

Objective of this Session

- To **approve** the draft Consultation Paper, *Public Sector Combinations*.

Agenda Material

2.1 Draft Consultation Paper, *Public Sector Combinations*

Background

1. At the March 2012 meeting, the IPSASB agreed that the draft Consultation Paper (CP), *Public Sector Combinations* should be restructured so it first distinguishes between acquisitions and amalgamations and then distinguishes between PSCs not under common control (NUCC) and PSCs under common control (UCC). The draft CP reflects this structure. The draft minutes are in Appendix A.
2. The IPSASB also agreed that a revised draft CP would be circulated to Members for an initial review before the June 2012 meeting, with the aim being to approve the draft CP at that meeting. Staff sent out the revised draft CP for review on May 14, 2012 and received comments from one Member and one TA. At the same time, the draft CP was reviewed by a “plain English” expert.

Overview of the Changes from the March 2012 Meeting

3. Appendix B lists the substantive changes made to the draft CP between the March 2012 meeting and this meeting.

Questions for the IPSASB

4. Staff would like to confirm four issues with the IPSASB. They are:
 - (a) Addition of the definition of “entity”;
 - (b) Whether the definitions sub-section of the Scope and Definitions section should be reordered;
 - (c) Reasons for using carrying amount for an acquisition NUCC; and
 - (d) Whether the Section on other issues relating to acquisitions should be kept (Section 7).

Addition of the Definition of “Entity”

5. A definition of “entity” has been included so that it can be distinguished it from an operation. This clarifies the relationship between, for example, a recipient (which is an entity) gaining control of an operation. In previous drafts of the CP, operation has been defined, but entity was not defined. Entity is defined as follows:

“An entity (for the purposes of this CP) is a public sector organization which comprises one or more operations.”

6. The definition relates to PSCs only because “entity” is used extensively in IPSASs and developing a definition that could be applied to all IPSASs is outside the scope of this project.

Action Requested:

Do you **agree** that a definition of “entity” should be included in the CP?

Whether the Definitions Sub-section of the Scope and Definitions Section should be Reordered?

7. The definitions sub-section of the Scope and Definitions Section is currently sequenced so that the item is first defined and then an explanation follows of what the definition means, including whether it is based on a definition used by another standard-setter. Staff has received a request to reorder this sub-section so that a discussion of the definition used by the other standard-setter is placed first and then the formation of the IPSASB’s definition is given. Staff has also had comments that the current structure of this sub-section is easy to follow and understand.

Action Requested:

Do you **agree** that the current structure of the sub-section on definitions is appropriate?

Reasons for using Carrying Amount for an Acquisition NUCC

8. The reasons for using carrying amount in the financial statements of a recipient for an acquisition NUCC are set out in paragraphs 5.18–5.23. These reasons have been developed over the course of this project. Staff has received requests for these reasons to be strengthened. Staff wishes to ask the IPSASB for feedback on how to improve these paragraphs.

Action Requested:

Can you **provide feedback** on how to improve paragraphs 5.18–5.23 of the draft CP?

Whether the Section on Other Issues Relating to Acquisitions should be kept (Section 7)?

9. Section 7 of the draft CP sets out three issues related to acquisitions. They are as follows:
- (a) Minority interests;
 - (b) Acquisition-related costs; and
 - (c) Subsequent accounting for goodwill.
10. Each of these topics has been included at the specific direction of the IPSASB over the course of this project. In particular, the inclusion of the topic on subsequent accounting for goodwill was requested at the March 2012 meeting. Staff has received comments that these issues distract the reader from the main issues relating to accounting for PSCs, and that the Section as it is currently

written, does not cover the issues in sufficient detail for a reader to be able to reach an informed decision. For example:

- (a) Acquisition-related costs affect other IPSASs, and therefore should be considered as a separate project to ensure consistency across all IPSASs; and
- (b) Subsequent accounting for goodwill only discusses two possible options rather than including a wide-ranging discussion.

11. Because of these comments, Staff wishes to ask the IPSASB for feedback on whether these topics should remain in the CP.

Action Requested:

Can you **provide feedback** on whether the following topics should remain in the CP:

- (a) Minority interests;
- (b) Acquisition-related costs; and
- (c) Subsequent accounting for goodwill?

Approval of Draft Consultation Paper

12. Staff wishes to ask the IPSASB if they will approve the publication of the draft CP.

Action Requested:

Do you **approve** the publication of the Consultation Paper, *Public Sector Combinations*?

Appendix A: Extract from Draft Minutes of the March 2012 Meeting

5. PUBLIC SECTOR COMBINATIONS

Discuss Issues and Review Draft Consultation Paper (Agenda Paper 6)

The staff presented a draft Consultation Paper (CP) on *Public Sector Combinations*.

A Member suggested that the draft CP needs to explain why the IPSASB is not using the term “entity combinations” and now uses the term “public sector combinations” (PSC).

Structure of the draft CP

The IPSASB discussed the appropriateness of the current structure of the draft CP which distinguishes first between PSCs not under common control (NUCC) and then PSCs under common control (UCC) before distinguishing between acquisitions and amalgamations. They concluded that the draft CP should be restructured so that it first distinguishes between acquisitions and amalgamations and then distinguishes between whether or not they are under common control. Because this was agreed upon at the end of the review of the draft CP, all comments below relate to the structure of the draft CP as it was presented in AP 6.1. Staff notes that the comments will be incorporated into the draft CP in the appropriate place according to the new structure. Consequential changes will also need to be made to the flow chart.

Section 2: Public Sector Combinations—Scope and Definitions

A Member suggested that the scope and definitions section of the draft CP should include more discussion of the issues before going into the detail of the definitions because this gives context to the definitions, and, then come to a preliminary view. This point is also relevant to other sections of the draft CP.

Another Member suggested that the focus on the related party nature of entities under common control was unnecessary and could be deleted. Instead, the focus should be on whether control exists as this is the stronger concept.

Another Member suggested that a sub-section needs to be added relating to recognition issues, (e.g., acquisition date).

Members made comments on specific paragraphs:

- **Paragraphs 2.1–2.3:** These paragraphs need to include an explanation of the history of the project and why the IPSASB has developed a consultation paper that deals with both PSCs not under common control and those under common control (i.e., the IPSASB previously issued an exposure draft based on an exchange versus non-exchange transaction distinction which was not well supported and that did not progress to a standard).
- **Paragraph 2.2:** Footnote 4 attached to this paragraph needs to be revised to relate to resulting entities.
- **Paragraph 2.5:** The explanation in this paragraph is not entirely true because related parties can exist for reasons other than an entity being part of an economic entity. Instead, the paragraph should focus on the fact that entities under common control are within an economic entity. In addition, this paragraph needs to refer to operations and not just to entities.

- **Paragraph 2.6:** This paragraph relates to profit-oriented entities and some of it belongs in the introduction section. The second sentence relating to the IASB consultation should be deleted. Text relating to profit-oriented entities should be relevant to the issue being discussed.
- **Paragraphs 2.7–2.10:** These paragraphs discuss the characteristics of entities under common control and entities not under common control. They need to be amended to reflect only characteristics where the economic substance differs and thus have consequences for financial reporting.
- **Paragraph 2.8:** This paragraph needs to be revised so that it relates to information asymmetry and how that may impact on financial reporting (e.g., IFRS 3 has a 12 month period subsequent to the acquisition to finalize the amounts recognized related to that acquisition). The last sentence should be deleted.
- **Paragraph 2.10:** Sub-paragraph (c) does not apply and should be deleted.
- **Paragraph 2.15:** The focus of this paragraph needs to be changed to working together to achieve common objectives from the current focus on lack of ownership interests.
- **Paragraph 2.17:** This paragraph needs to be expanded when discussing the entity losing control (i.e., derecognition), because IPSASs do not have an equivalent to IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*.
- **Paragraph 2.19:** This paragraph is not clear as to which entity is in the scope of the draft CP and how the draft CP relates to single financial statements. This point links with previous comment on footnote 4 of paragraph 2.4. This is an important point as many ministries or departments within a government that is a single entity are also separate reporting entities. Paragraphs 2.20–21 will need to be updated as a result.
- **Paragraph 2.22, Table 2:** The box relating to the ultimate economic entity for an acquisition not under common control needs to be revised because the ultimate economic entity is affected by an acquisition not under common control as the net assets acquired by the recipient, and any goodwill arising, will be incorporated into the ultimate economic entity's consolidated financial statements. This project will specify the accounting treatment for goodwill and so may impact on the ultimate economic entity.
- **Paragraph 2.25:** This paragraph should be revised along the lines of "issues relating to disclosures will be addressed subsequent to the review of responses to the CP..."
- **Paragraphs 2.37 and 2.39–2.43:** The ordering of the definitions should be control first and then common control.
- **Paragraph 2.37:** The definition of common control should be revised, as follows. Common control is defined as "all of the operations are ultimately controlled by the same entity."
- **Paragraph 2.43, Table 3:** The definition of a newly controlled operation should be deleted. Rather it should be used as a description only.

Section 3: Methods of Accounting for PSCs and Measurement Bases

The IPSASB discussed the definition of fair value, the explanation as to how it is applied in IPSASs and that the IASB defines fair value differently (paragraphs 3.8–3.10). A Member commented that the IASB's model is a method of obtaining fair value for exchange transactions and this needs to be made clear.

Another Member asked whether the draft CP should use the term fair value if the IASB has defined, and is using it, in a different way to how IPSASs currently define and use fair value. It was agreed that a Specific Matter for Comment should be included asking whether fair value is the appropriate term to use given that the IASB uses it in a different way to the IPSASB.

A Member suggested that this section needs to include a sub-section discussing recognition because the use of the pooling of interests method results in recognition at an earlier date than either the acquisition method or the fresh start method. It was noted that other sections of the draft CP need to include a discussion on recognition.

Members made comments on specific paragraphs:

- **Paragraph 3.4:** The third sentence needs to refer to the fact that it is due to specific accounting requirements that the recipient recognizes identifiable assets and liabilities acquired, including those not previously recognized by the acquiree. The fourth sentence should be deleted as the example given is a private sector entity example and thus is not relevant to public sector entities. The eighth sentence should be revised as follows: “The acquirer recognizes in its financial statements identifiable net assets and liabilities of the acquiree at CU100...”
- **Paragraph 3.9:** The first sentence of this paragraph should be revised to say “This definition of fair value is applied in IPSASs as the amount...”
- **Paragraph 3.13:** The last sentence of this paragraph should be revised to say “Therefore, this type of business combination had to be undertaken with a substantially equal exchange of shares between the shareholders of the combining entities.”
- **Paragraphs 3.17–20:** These paragraphs discuss carrying amount as the measurement approach used in the pooling of interests method and include a discussion of qualitative characteristics. This has not been done for the discussion of fair value in the acquisition method (paragraphs 3.8–3.10) or for the discussion of the fresh start method (paragraphs 3.21–3.24). The discussion in each of these sub-sections should be made consistent with the discussion relating to the qualitative characteristics of the carrying amount and moved to a later section of the draft CP.
- **Paragraph 3.25:** Table 5: This Table should be revised to have a sub-heading “Accounting Decisions” for measurement basis and a new line should be inserted for recognition point. The sub-heading for the subsequent lines should be “Implications.” The text in the measurement basis box for the pooling of interests method should be revised to: “~~No remeasurement, all of the~~ Combining operations’ financial statement items are recognized without remeasurement, at carrying amount, except...” In addition, the text relating to accumulated surplus or deficit for the purchase or acquisition method should be revised so that it is consistent with the text relating to the pooling of interests method.

Section 4: The Boundary between Acquisitions and Amalgamations

The IPSASB agreed that this section should be placed immediately after the scope and definitions sections.

Paragraph 4.6(a) should be deleted.

Section 5: Accounting for Public Sector Combinations not under Common Control: Acquisitions

The IPSASB noted that the discussion relating to qualitative characteristics should be based on those set out in IPSAS 1 rather than on CF–ED1 to be consistent with other decisions in the draft CP relating to the use of current IPSASs. For example paragraph 5.17 refers to verifiability whereas IPSAS 1 does not.

A TA commented that this section does not deal with the issue of goodwill and whether it can arise in the public sector. For most acquisitions in the public sector there is only one potential recipient negotiating with the transferor, contrasting with the private sector where there is usually more than one potential acquirer. This can mean that the recipient imposes conditions and the transaction may not be undertaken by willing parties. Examples of this situation can be where there is a forced transaction, nationalization or an emergency situation. The IPSASB agreed that a sub-section needed to be included relating to whether goodwill could arise in these situations.

Members made comments on specific paragraphs:

- **Paragraph 5.15:** This paragraph needs to be revised as it is the acquisition method that provides a faithful representation and not fair value.
- **Paragraph 5.19:** The repetition in this paragraph relating to the first sentence needs to be deleted as this is stated earlier in the draft CP.
- **Paragraph 5.30:** This paragraph needs to start with “Some believe...”
- **Paragraph 5.33:** This paragraph needs to be revised so that the rationale for the use of carrying amount where no consideration is transferred is because it makes sense to use carrying amount even though it is not consistent with IPSAS 23. It was noted that the use of fair value in IPSAS 23 was a practical decision. In addition, this paragraph needs to be revised so that it does not sound like an IPSASB view.
- **Paragraph 5.35:** This paragraph needs to be revised to reflect the situation where nominal consideration is transferred.
- **Paragraph 5.40:** This paragraph refers to “gross inflow” to explain why the term gain is used rather than revenue, but the explanation is not clear because a gross inflow can also relate to discounts or rebates, so this paragraph should be deleted or revised.
- **Paragraph 5.47, Table 6:** The order of the lines “goodwill” and “gain” from bargain purchase need to be swapped so they are consistent with the left-hand columns of the table.
- **Paragraph 5.55, Potential Preliminary View:** A rationale needs to be added to this potential preliminary view.

Section 6: Accounting for Public Sector Combinations not under Common Control: Amalgamations

No comments.

Section 7: Accounting for Public Sector Combinations under Common Control: Acquisitions and Amalgamations

A Member suggested that the sub-section on “Treatment of the Difference Arising in Acquisitions Under Common Control: Recipient Accounting” (paragraphs 7.7–7.9) should be expanded to include the option

for gains or losses to be recognized directly in accumulated surplus or deficit, or be treated as contributions from owners or distributions to owners.

Members made comments on specific paragraphs:

- **Paragraph 7.6:** This paragraph needs to include the point that because the acquisition occurs under common control there is no change in the ultimate controlling entity.
- **Paragraph 7.8:** The wording of the first sentence needs to be revised to: “The acquisition calculation ~~of the difference arising~~ may include consideration.”

Next Steps

The IPSASB agreed that a revised draft CP, including the new structure, will be circulated to Members for an initial review before the June 2012 meeting.

Appendix B: Summary of Changes to the draft CP from March 2012 to June 2012

Section in draft CP	Comment
Overall structure	<p>Structure has been revised, as follows:</p> <ul style="list-style-type: none"> • Introduction • Scope and Definitions • The Boundary between Acquisitions and Amalgamations • Accounting for PSCs • Accounting for Acquisitions NUCC • Accounting for Acquisitions UCC • Accounting for Acquisitions—Other Issues <ul style="list-style-type: none"> ○ Minority Interests ○ Acquisition-Related Costs ○ Subsequent Accounting for Goodwill • Accounting for Amalgamations • Appendix A: Proposed and Existing Definitions • Appendix B: Examples of the Scope of this CP • Appendix C: Flow Chart
Preliminary Views and Specific Matters for Comment	<p>Preliminary Views and Specific Matters for Comment have been included where appropriate.</p>
Objectives of Financial Reporting and Qualitative Characteristics	<p>Reference to the objectives of financial reporting and the qualitative characteristics has been changed from CF–ED1 to IPSAS 1 and the relevant text has been amended where necessary.</p>
Scope and Definitions	<ul style="list-style-type: none"> • In the draft CP for the March 2012 meeting, scope and definitions were separate sub-sections. They have now been combined so that scope is discussed first and then the related definitions are discussed. • A definition has been inserted for “entity” so that it can be distinguished from “operation.” • The definition of an operation has been revised so that it does not overlap with the definition of an asset, as follows (new text underlined and deleted text struck through): “An integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity’s objectives, <u>by providing goods and/or services</u> either by providing economic benefits or service potential.” • The definition of an amalgamation has been revised to ensure that the formation of a joint venture is excluded from its scope, as follows (new text underlined): “A transaction or other event where <u>(a)</u> two or more operations combine, <u>(b)</u> none of the combining operations gain control of the other operations, and <u>(c)</u> <u>the transaction or other event is not the formation of a joint venture.</u>” • The sub-section relating to parties to a PSC which are in the scope of the CP has been significantly expanded and includes illustrative diagrams. • The scope exclusion for the formation of a joint venture has been significantly revised.
Accounting for PSCs	<ul style="list-style-type: none"> • Now includes text relating to recognition. • Moved text relating to modification of the pooling of interests method of

Section in draft CP	Comment
	accounting from amalgamations section to this section.
Accounting for Acquisitions NUCC	<p>Structure has been revised, as follows:</p> <ul style="list-style-type: none"> • Introduction • When to Recognize an Acquisition • What is the Appropriate Measurement Basis or Approach? <ul style="list-style-type: none"> ○ Approach A: Use of Fair Value as the Measurement Basis for all Acquisitions ○ Approach B: Potential Distinction between Acquisitions based on whether or not Consideration is Transferred • What is the Appropriate Treatment of the Difference Arising? <ul style="list-style-type: none"> ○ Treatment of Difference Arising Where Recipient Acquires Net Assets and No or Nominal Consideration is Transferred ○ Treatment of Difference Arising Where Recipient Assumes Net Liabilities and No or Nominal Consideration is Transferred ○ Treatment of Difference Arising Where Consideration Transferred is in Excess of Net Assets Acquired (this sub-section discusses whether it should be goodwill or a loss) ○ Treatment of Difference Arising Where Net Assets Acquired are in Excess of Consideration Transferred • Summary
Accounting for Acquisitions UCC	The sub-section relating to the appropriate accounting treatment of the difference arising in the GPFSs of the recipient now includes a discussion of contributions from owners or distributions to owners and gain or loss recognized directly in net assets/equity. Because of these changes, there are consequential amendments to the sub-section on transferor accounting.
Accounting for Acquisitions—Other Issues	<ul style="list-style-type: none"> • The discussion relating to minority interests and acquisition-related costs has been revised. • Discussion on subsequent accounting for goodwill has been added.
Accounting for Amalgamations	This section has been revised to discuss amalgamations generally and includes additional text where it may be different for amalgamations UCC. The analysis as to whether to use the modified pooling method of accounting or fresh start accounting has been significantly revised.
Appendix A	This appendix has been added (and existing Appendix A is now Appendix B) to include an alphabetical list of the proposed and existing definitions used in the CP and cross-references to the relevant paragraphs in the body of the CP.
Appendix B	<ul style="list-style-type: none"> • Includes a new example relating to a public sector entity acquiring a GBE. • Includes a new example relating to two public sector entities forming a joint venture, which is outside the scope of this CP.
Appendix C	The Flow Chart has been significantly revised.

**IPSASB
Consultation Paper**

June 2012

Comments due: October 31, 2012

*International Public Sector Accounting Standards
Board*

Public Sector Combinations

The International Public Sector Accounting Standards Board (IPSASB) sets International Public Sector Accounting Standards (IPSASs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies. A key part of the IPSASB's strategy is to converge the IPSASs, to the extent appropriate, with the IFRSs issued by the IASB.

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening transparency and accountability of public sector finances.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants (IFAC).

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REQUEST FOR COMMENTS

This Consultation Paper (CP), *Public Sector Combinations*, was developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The proposals in this CP may be modified in light of comments received before being issued in final form. **Comments are requested by October 31, 2012.**

Respondents are asked to submit their comments electronically through the IPSASB website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. Although IPSASB prefers that comments are submitted via its website, comments can also be sent to Stephenie Fox, IPSASB Technical Director at stepheniefox@ipsasb.org.

This publication may be downloaded free of charge from the IPSASB website: www.ipsasb.org. The approved text is published in the English language.

Objective of the Consultation Paper

The objective of this Consultation Paper (CP) is to initiate discussion on the possible accounting treatment for public sector combinations (PSCs) in the general purpose financial statements (GPFSS) of an entity that uses accrual-based IPSASs.

Guide for Respondents

The IPSASB would welcome comments on all of the matters discussed in this CP. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate and contain a clear rationale.

The Preliminary Views for Comment in this CP are provided below. Paragraph numbers identify the location of the Preliminary View in the text.

Preliminary View 1 (following paragraph 2.19):

A **public sector combination** is the bringing together of separate operations into one entity, either as an acquisition or an amalgamation.

The key definitions are as follows:

- An **acquisition** is a transaction or other event that results in a recipient gaining control of one or more operations.
- An **amalgamation** is a transaction or other event where (a) two or more operations combine, (b) none of the combining operations gain control of the other operations, and (c) the transaction or other event is not the formation of a joint venture.
- A **combining operation** is an operation that combines with one or more other operations to form the resulting entity.
- An **entity** (for the purposes of this CP) is a public sector organization which comprises one or more operations.
- An **operation** is an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services.

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- A **recipient** is the entity that gains control of one or more operations.
- A **resulting entity** is the entity that is the result of two or more operations combining where none of the combining operations gains control of the other operations.
- A **transferor** is the entity that loses control of one or more of its operations to another entity (the recipient) in an acquisition.

Preliminary View 2 (following paragraph 2.26):

A **public sector combination under common control** is a public sector combination in which all of the entities or operations involved are controlled by the same entity or ultimately controlling entity both before and after the public sector combination.

Preliminary View 3 (following paragraph 3.14):

The sole definitive criterion for distinguishing an amalgamation from an acquisition is that, in an amalgamation, none of the combining operations gain control of the other operations.

Preliminary View 4 (following paragraph 5.4):

An acquisition NUCC should be recognized in the financial statements of the recipient on the date the recipient gains control of the acquired operation.

Preliminary View 5 (following paragraph 5.47):

The recipient in an acquisition NUCC recognizes in its financial statements on the date of acquisition, the difference arising as:

- (a) A gain where the recipient acquires net assets in excess of consideration transferred (if any); and
- (b) A loss where the recipient assumes net liabilities.

Preliminary View 6 (following paragraph 6.5):

An acquisition UCC should be recognized in the financial statements of the recipient on the date the recipient gains control of the acquired operation.

Preliminary View 7 (following paragraph 6.8):

The recipient in an acquisition UCC recognizes in its financial statements on the date of acquisition, the assets acquired and the liabilities assumed in one or more acquired operations, at carrying amount.

Preliminary View 8 (following paragraph 7.10):

A minority interest should be measured as a proportionate share of the acquired operation's net assets.

Preliminary View 9 (following paragraph 7.15):

Acquisition-related costs should be an expense in surplus or deficit (in the statement of financial performance) in the period in which the services are received.

Preliminary View 10 (following paragraph 8.12):

A resulting entity in an amalgamation should apply the modified pooling of interests method of accounting.

Preliminary View 11 (following paragraph 8.15):

Where combining operations continue to prepare and present GPFs using accrual-based IPSASs in the period between the announcement of the amalgamation and the date of the amalgamation, these are prepared on a going concern basis where the resulting entity will fulfill the responsibilities of the combining operations.

The Specific Matter for Comments requested in this CP are provided below. Paragraph numbers identify the location of the Specific Matter for Comment in the text.

Specific Matter for Comment 1 (following paragraph 2.52):

In your view, is the scope of this CP appropriate?

Specific Matter for Comment 2 (following paragraph 2.52):

In your view, is the approach to distinguish between acquisitions and amalgamations, with a further distinction for PSCs NUCC and PSCs UCC, appropriate? If you do not support this approach, what alternatives should be considered? Please explain your reasoning.

Specific Matter for Comment 3 (following paragraph 3.14):

In your view, are there other public sector characteristics that should be considered in determining whether one party has gained control of one or more operations?

Specific Matter for Comment 4 (following paragraph 5.25):

In your view, should the recipient in an acquisition NUCC recognize in its financial statements, the acquired operation's assets and liabilities by:

- (a) Applying fair value measurement to the identifiable assets acquired and liabilities assumed in the operation at the date of acquisition for all acquisitions (Approach A); or
- (b) Distinguishing between different types of acquisitions (Approach B) so that:
 - (i) The carrying amounts of the assets and liabilities recognized in the acquired operation's financial statements are adopted, except where amounts are adjusted to align the operation's accounting policies with those of the recipient, at the date of acquisition, for acquisitions where no or nominal consideration is transferred; and
 - (ii) Fair value measurement is applied to the identifiable assets acquired and liabilities assumed in the operation, at the date of acquisition, for acquisitions where consideration is transferred?

Please explain why you support Approach A or Approach B.

Specific Matter for Comment 5 (following paragraph 5.47):

In your view, where the consideration transferred is in excess of the net assets acquired, should the difference arising in an acquisition NUCC (for both Approach A and Approach B, acquisitions where consideration is transferred) be recognized in the recipient's financial statements, on the date of acquisition, as:

- (a) Goodwill for acquisitions where the acquired operation is cash-generating and a loss for all other acquisitions;

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- (b) Goodwill for all acquisitions (which would require development of a definition of goodwill that encompasses the notion of service potential); or
- (c) A loss for all acquisitions?

Please explain why you support (a), (b), or (c).

Specific Matter for Comment 6 (following paragraph 6.25):

In your view, should the recipient in an acquisition UCC recognize in its financial statements, on the date of acquisition, the difference arising as:

- (a) A gain or loss recognized in surplus or deficit (in the statement of financial performance);
- (b) A contribution from owners or distribution to owners recognized directly in net assets/equity (in the statement of financial position); or
- (c) A gain or loss recognized directly in net assets/equity (in the statement of financial position), except where the transferor is the ultimate controlling entity and recognized as a contribution from owners or distribution to owners?

Please explain why you support (a), (b), or (c).

Specific Matter for Comment 7 (following paragraph 6.31):

In your view, should the accounting treatment for the recipient and transferor of an acquisition UCC be symmetrical?

Specific Matter for Comment 8 (following paragraph 7.21):

If it is determined that goodwill does meet the definition of an asset in the public sector, in your view, should the subsequent accounting of goodwill be:

- (a) Non-amortization, with an impairment test annually or more frequently if events or changes in circumstances indicate that it might be impaired;
- (b) Amortization on a systematic basis over its useful life; or
- (c) Another approach?

Please explain why you support (a), (b), or (c).

Executive Summary

The objective of this Consultation Paper (CP) is to initiate discussion on the possible accounting treatment for public sector combinations (PSCs) in the general purpose financial statements (GPFs) of an entity that uses accrual-based IPSASs. It considers matters such as, the timing of recognition, and the initial measurement basis or bases that could be adopted for the wide range of combinations that may occur in the public sector.

Currently, IPSASs do not provide guidance on how to account for a public sector combination—instead, IPSAS 6, *Consolidated and Separate Financial Statements* explains that guidance on accounting for entity combinations can be found in the relevant international or national accounting standard dealing with business combinations. This means that there may not be consistent or appropriate reporting of such combinations in the GPFs of public sector entities. Consequently, users may not be able to obtain the information needed to evaluate the nature and financial effect of a PSC.

This CP defines a PSC as “the bringing together of separate operations into one entity, either as an acquisition or an amalgamation.” An acquisition is defined as “transaction or other event where a recipient gains control of one or more operations,” and an amalgamation is defined as “a transaction or other event where (a) two or more operations combine, (b) none of the combining operations gain control of the other operations, and (c) the transaction or other event is not the formation of a joint venture.”

For acquisitions, this CP considers separately (a) acquisitions that take place between parties that are controlled by the same entity or ultimate controlling entity, in other words, under common control (UCC), and (b) acquisitions that take place between parties that are not controlled by the same entity or ultimate controlling entity, i.e., not under common control (NUCC). For amalgamations, the IPSASB considers that the factors relating to the choice of accounting treatment do not differ between amalgamations NUCC and amalgamations UCC. Hence, the CP discusses the possible accounting treatment for amalgamations without distinguishing whether or not they take place UCC.

This CP considers that an acquisition NUCC should be recognized in the recipient’s GPFs on the date the recipient gains control of the acquired operation, i.e., the acquisition date. However, the IPSASB has not reached a conclusion as to whether other features of the acquisition method of accounting, such as the use of fair value as the measurement basis, are appropriate for some or all acquisitions in the public sector. The CP sets out two approaches to determining the appropriate measurement basis or bases to apply to the acquired operation’s assets and liabilities, as follows.

- Applying fair value measurement to the identifiable assets acquired and liabilities assumed in the operation at the date of acquisition for all acquisitions (Approach A); or
- Distinguish between different types of acquisitions (Approach B) so that:
 - The carrying amounts of the assets and liabilities recognized in the acquired operation’s financial statements are adopted, except where amounts are adjusted to align the operation’s accounting policies with those of the recipient, at the date of acquisition, for acquisitions where no or nominal consideration is transferred; and
 - Fair value measurement is applied to the identifiable assets acquired and liabilities assumed in the operation, at the date of acquisition, for acquisitions where consideration is transferred.

The difference arising from an acquisition NUCC should be recognized by the recipient as (a) a gain in surplus or deficit where the recipient acquires net assets in excess of consideration transferred (if any), and (b) a loss in surplus or deficit where the recipient assumes net liabilities. The IPSASB has not

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reached a conclusion as to whether the difference arising where the consideration transferred is in excess of the net assets acquired should be recognized as goodwill (in the statement of financial position), or a loss (in the statement of financial performance).

For acquisitions UCC, this CP considers that the recipient should recognize the acquisition on the date the recipient gains control of the acquired operation, and recognizes the assets acquired and the liabilities assumed at carrying amount, except where amounts are restated to align the accounting policies of the acquired operation to those of the recipient. The CP considers three options for the accounting treatment of the difference arising (a) a gain or loss recognized in surplus or deficit, (b) a contribution from owners or distribution to owners, and (c) a gain or loss recognized directly in net assets/equity. The CP briefly considers the accounting treatment for the transferor in an acquisition UCC because two of the alternatives for the accounting treatment of the difference arising in the recipient's GPFs would result in asymmetrical accounting treatment between the recipient and the transferor.

For amalgamations, this CP considers that the sole definitive criterion for distinguishing an amalgamation from an acquisition is that, in an amalgamation, none of the combining operations gain control of the other operations. The CP considers that the resulting entity should apply the modified pooling of interests method of accounting. This method requires recognition of the amalgamation on the date it takes place. As a consequence, the surplus or deficit in the year of the amalgamation commences from the date of the amalgamation, and there are no comparatives for the first reporting period. The combining operations' financial statement items are recognized without remeasurement at carrying amount, except where amounts are restated to align the accounting policies of the combining operations to those of the resulting entity. The CP also briefly considers the accounting treatment for the combining operations in the period between the announcement of the amalgamations and the date of the amalgamation.

Respondents are directed to the *At a Glance Consultation Paper Summary* located on the IPSASB website. This staff document provides a brief and useful overview of this Consultation Paper.

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1 Introduction

- 1.1 This Consultation Paper (CP) considers approaches to, and issues in, accounting for public sector combinations (PSCs) in the general purpose financial statements (GPFs) of an entity that uses accrual-based IPSASs. Its objective is to initiate discussion about matters such as (a) the timing of recognition, and (b) the initial measurement basis or bases that should be adopted for the wide range of combinations that may occur in the public sector.
- 1.2 IPSAS 1, *Presentation of Financial Statements*, explains that “the objectives of general purpose financial statements are to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making and evaluating decisions about the allocation of resources. Specifically, the objectives of general purpose financial reporting [GPFR] in the public sector should be to provide information useful for decision making, and to demonstrate the accountability of the entity for the resources entrusted to it.”¹ For decisions about the allocation of resources and assessing the accountability of the entity for its use of resources, users need to be able to identify and evaluate the nature and financial effect of a public sector combination that takes place during a reporting period.
- 1.3 Currently, IPSASs do not provide guidance on how to account for a public sector combination—instead, IPSAS 6, *Consolidated and Separate Financial Statements*, explains that guidance on accounting for entity combinations can be found in the relevant international or national accounting standard dealing with business combinations. This means that there may not be consistent or appropriate reporting of such combinations in GPFs. Consequently, users may not be able to obtain the information needed to identify the type of PSC and evaluate its nature and financial effect. This CP is the first step in determining the requirements and guidance appropriate for PSCs.
- 1.4 The CP uses the term “public sector combinations”² rather than “business combinations,” the term generally used for this type of transaction or other event by profit-oriented entities. The different terminology is considered useful, because it reflects key differences in the circumstances in which PSCs and business combinations may arise. Here are three examples:
- The objective of a business and a business combination is generally to generate profits, whereas the objective of public sector entities is generally to deliver goods and services for community or social benefit, rather than to generate profits. The objectives of combinations of public sector entities are generally to, for example, (a) achieve a more effective distribution of responsibilities and associated activities, (b) reflect changing demographics, or (c) to deliver a greater volume, more efficient or better quality of public goods or services.
 - Many PSCs take place by way of non-exchange transactions, whereas for profit-oriented entities, the large majority of combinations arise as a result of exchange transactions. Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value to another entity in

¹ The IPSASB is currently undertaking a project to develop a *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* which proposes that “the objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of [general purpose financial reports] GPFRs for accountability purposes and for decision-making purposes (paragraph 2.1 of CF-ED1).

² For ease of reference, Appendix A includes a list of proposed and existing definitions used in this CP.

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exchange.³ 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.⁴

- Many business combinations occur voluntarily. A PSC may be undertaken voluntarily or can be required by legislation or other authority.

History of the Project

- 1.5 The IPSASB commenced a project on public sector combinations in 2008. At that stage, the project was named “entity combinations.” The project was split into two parts: (a) entity combinations arising from exchange transactions—a limited convergence project with IFRS 3, *Business Combinations*, and (b) entity combinations arising from non-exchange transactions—a public sector-specific project.
- 1.6 The limited convergence project adapting IFRS 3 where appropriate for the public sector, was commenced to deal with any entity combinations in the public sector that are similar in nature to business combinations undertaken by 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 approximately equal values is embedded in the Standard. It resulted in the issue of ED 41, *Entity Combinations from Exchange Transactions*, in May 2009.
- 1.7 IFRS 3 includes bargain purchases within its scope. Some respondents noted that because of the inclusion of bargain purchases, it could be argued that IFRS 3 also applies to at least some non-exchange entity combinations. These respondents were concerned about the application of the IFRS 3 approach to non-exchange entity combinations. The IPSASB noted these arguments. The IPSASB acknowledged that it may be difficult to establish a clear demarcation between all exchange and non-exchange entity combinations. Moreover, it was not clear whether combinations where no party gains control of the other parties to the combination would be within the scope of ED 41, and therefore required to be accounted for as an acquisition. Consequently, the IPSASB decided not to develop ED 41 into an IPSAS.

Approach taken in this CP

- 1.8 The IPSASB decided to develop this CP to consider more broadly the approaches to accounting that might be adopted for PSCs arising in different circumstances. Therefore, the CP considers the wide range of combinations that may occur in the public sector, and, consequently, this project is not an IFRS convergence project.
- 1.9 Whilst it was decided not to continue with the development of ED 41, there are aspects of IFRS 3 that are still relevant to this project. In particular, some of the proposed definitions relating to PSCs are based upon definitions in IFRS 3. Also, the accounting treatment required by IFRS 3, i.e., the acquisition method, is described to give context to discussion in the CP relating to acquisitions.
- 1.10 The approach taken in this CP is to distinguish between combinations that take place within a single entity or an economic entity, i.e., under common control, and combinations where the parties

³ Paragraph 11 of IPSAS 9, *Revenue from Exchange Transactions*.

⁴ Paragraph 11 of IPSAS 9.

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to the combination are not controlled by the same controlling party or ultimate controlling party, i.e., not under common control. A further distinction is made between combinations where one party gains control of another party and combinations where no party gains control of the other parties to the combination. The reasons underlying this approach are set out in Sections 2 and 3.

2 Scope and Definitions

Definition of a Public Sector Combination

2.1 For the purposes of this CP, a *public sector combination* is defined as follows:

“The bringing together of separate operations into one entity, either as an acquisition or an amalgamation.”

2.2 The scope of this CP includes all types of PSCs, and is not limited to one entity gaining control of one or more operations or PSCs that arise from an exchange transaction. The CP therefore considers the financial reporting of a PSC when:

- (d) An entity gains control of one or more operations (acquisition) undertaken with or without the transfer of consideration; and
- (e) Two or more operations combine, with none of the combining operations gaining control of the other operations (amalgamation).

2.3 For the purposes of this CP⁵, an entity is defined as follows:

“An entity (for the purposes of this CP) is a public sector organization which comprises one or more operations.”

2.4 An entity may be, for example, a government, department, agency or other public sector organization, including an international public sector organization. There may also be several layers of entities within one larger entity. This is because the structure of public sector entities varies between jurisdictions. An example of such a structure could be a government, such as a province, that is a single entity, and all of its departments, such as the Department of Health, are entities within that single larger entity.

2.5 An “operation” is defined as follows:

“An integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity’s objectives, by providing goods and/or services.”

2.6 An operation can include (a) activities and assets, (b) activities and liabilities, or (c) activities and assets and liabilities. Furthermore, the use of the term operation means that a PSC can involve the acquisition of an entity which comprises a number of operations or the acquisition of part of an entity or, for an amalgamation, the combining of several components from separate entities into one entity.

2.7 The definition of operation is based upon the term “business” from IFRS 3. The definition of “business” in IFRS 3 is as follows:

“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.”⁶

⁵ IPSASs do not define “entity.” However, “entity” is used extensively in accrual-based IPSASs and developing a definition of it that could be applied to all accrual-based IPSASs is outside the scope of this project. Hence, the definition of “entity” applies to this CP only.

⁶ Appendix A of IFRS 3.

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- 2.8 For application in the public sector, the term “business” has been amended to “operation” and the definition has been amended to:
- (a) Include the notion of the provision of goods and services rather than providing a return to investors, because this is a major activity of most public sector entities—this has been achieved by the use of the phrase “by providing goods and/or services”; and
 - (b) Acknowledge that a public sector operation may involve activities directed at the management of liabilities as well as use of assets for the delivery of services—this has been achieved by the use of the phrase “activities and related assets and/or liabilities.”
- 2.9 An operation must include “an integrated set of activities.” A combination of an asset and/or liability or a group of assets and/or liabilities without a related integrated set of activities does not constitute an operation and therefore does not meet the definition of a PSC.
- 2.10 The discussion in this CP applies to entities that prepare and present GPFs in accordance with accrual-based IPSASs. The CP does not address how to apply accrual-based IPSASs for the first time. For example, where a public sector entity that applies accrual-based IPSASs gains control of an operation that applies the cash basis of accounting, the controlling entity adopts accrual-based IPSASs for that operation on the date of the acquisition. Another example may be where the entity that is a result of an amalgamation applies accrual-based IPSASs, and one or more of the combining operations apply the cash basis of accounting, the resulting entity adopts accrual-based IPSASs for that operation or those operations on the date of the amalgamation. Guidance on moving to accrual-based IPSASs from a cash basis of accounting can be found in the specific transitional provisions of individual IPSASs, and in Study 14, *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities* (Third Edition), issued in January 2011.

Definition of an Acquisition

- 2.11 An *acquisition* is defined as follows:

“A transaction or other event that results in a recipient gaining control of one or more operations.”

- 2.12 IPSAS 6, *Consolidated and Separate Financial Statements*, defines “control” as “the power to govern the financial and operating policies of another entity so as to benefit from its activities.” The term “control” is used in this definition with the same meaning as that in IPSAS 6.
- 2.13 The IPSASB is currently proceeding with two projects that have the potential to change the use of the term control and its definition in IPSASs. They are the *Conceptual Framework* project⁷ and the *Revision of IPSASs 6–8* project. The outcome of these projects may affect the definition and use of

⁷ 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, does not define or use the term control when exploring the underlying principles of a group reporting entity, and paragraph 4.9 of CF–ED1 states:

“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.”

the term “control.” The IPSASs will be reviewed for consistency when these projects are completed.⁸

2.14 The parties to an acquisition are defined as follows:

“A **recipient** is the entity that gains control of one or more operations.”

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

2.15 Where one entity gains control of one or more operations during the reporting period, the entity that loses control of the operation is the *transferor*, and the entity that gains control of the operation is the *recipient*.⁹ An acquisition may occur, for example, when an operation is transferred from one government department to another government department.

2.16 The terms “recipient” and “transferor” are used in IPSAS 23, *Revenue from Non-exchange Transactions (Taxes and Transfers)*. The entity that transfers assets in a non-exchange transaction to another entity is the transferor, and the entity that obtains the transfer is the recipient. The use of these terms in IPSAS 23¹⁰ is consistent with the way the terms are used for PSCs in this CP, whether the PSC arises from an exchange or non-exchange transaction.

Definition of an Amalgamation

2.17 An *amalgamation* is defined as follows:

“A transaction or other event where (a) two or more operations combine, (b) none of the combining operations gain control of the other operations, and (c) the transaction or other event is not the formation of a joint venture.”¹¹

2.18 The parties to an amalgamation are defined as follows:

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

“A **resulting entity** is the entity that is the result of two or more operations combining where none of the combining operations gains control of the other operations.”

2.19 The entity that is the result of the amalgamation is termed the *resulting entity*. The operations that combine are termed the *combining operations*. An amalgamation may occur, for example, when two local governments combine into one entity.

⁸ Other aspects of the Conceptual Framework project, e.g., the definitions of elements, may also have implications for any final standard arising from this project.

⁹ These terms differ from those used for an acquisition in IFRS 3 because of the differences between public sector acquisitions and business combinations. The terms in IFRS 3 are “acquirer” rather than “recipient.” IFRS 3 defines the “acquiree,” however this CP does not define the equivalent of acquiree; instead, it describes it as an “acquired operation.” IFRS 3 does not define the equivalent of “transferor”; instead, it refers to “former owners.”

¹⁰ 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.”

¹¹ The exclusion of a joint venture is discussed in paragraphs 2.49–2.52.

Preliminary View 1:

A **public sector combination** is the bringing together of separate operations into one entity, either as an acquisition or an amalgamation.

The key definitions are as follows:

- An **acquisition** is a transaction or other event that results in a recipient gaining control of one or more operations.
- An **amalgamation** is a transaction or other event where (a) two or more operations combine, (b) none of the combining operations gain control of the other operations, and (c) the transaction or other event is not the formation of a joint venture.
- A **combining operation** is an operation that combines with one or more other operations to form the resulting entity.
- An **entity** (for the purposes of this CP) is a public sector organization which comprises one or more operations.
- An **operation** is an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services.
- A **recipient** is the entity that gains control of one or more operations.
- A **resulting entity** is the entity that is the result of two or more operations combining where none of the combining operations gains control of the other operations.
- A **transferor** is the entity that loses control of one or more of its operations to another entity (the recipient) in an acquisition.

Distinction between PSCs under Common Control and those not under Common Control

- 2.20 A PSC that takes place between entities within an economic entity is characterized as being “under common control” (UCC). The term “economic entity” is defined as “a group of entities comprising a controlling entity and one or more controlled entities.”¹² Furthermore, an amalgamation may involve both entities and operations where it combines operations that were previously a part of an entity. Where these entities and operations are controlled by the same entity or ultimate controlling entity, they are UCC.
- 2.21 The distinguishing feature of a PSC UCC is that the parties to a PSC are controlled by the same entity or ultimate controlling entity. It follows that the distinguishing feature of a PSC not under common control (NUCC) is that the parties to the PSC are not controlled by the same entity or ultimate controlling entity.
- 2.22 Section 6 explores whether a PSC that is an acquisition UCC warrants different accounting treatment than that proposed for acquisitions NUCC.

¹² Paragraph 7 of IPSAS 1 defines controlling entity as “an entity that has one or more controlled entities,” and controlled entity as “an entity, including an unincorporated entity such as a partnership, which is under the control of another entity (known as the controlling entity).”

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Definition of a Public Sector Combination under Common Control

2.23 A public sector combination under common control (PSC UCC) is defined as follows:

“A public sector combination in which all of the entities or operations involved are controlled by the same entity or ultimate controlling entity both before and after the public sector combination.”

2.24 The definition of a PSC UCC is based on the description in IFRS 3 for a business combination under common control:

“A business combination involving entities or businesses under common control is a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory.”¹³

2.25 For application in the public sector, the terminology has been amended to reflect the above terminology relating to PSCs and operations. The wording of the definition has been amended to read as follows:

- (a) Remove the notion that a group of individuals are regarded as the ultimate controlling party when, as a result of contractual arrangements, those individuals collectively control the entity, because this does not occur in the public sector—this has been achieved by deleting the phrase “or parties” and, in addition, the term “party” has been replaced with the phrase “entity or operation,” so that the terminology is consistent with the other definitions relating to PSCs;
- (b) Remove the condition that control must not be transitory, because this condition is to prevent the use of specific transactions, whereby, for a brief period immediately before the combination, the combining entities or businesses are UCC and thus would be outside the scope of IFRS 3, because this is unlikely to occur in the public sector—this has been achieved by deleting this condition; and
- (c) Remove the “combining” otherwise the definition does not include acquisitions because “combining” is specifically used in the definitions relating to amalgamations.

2.26 The wording of the definition has also been amended to include situations where a PSC takes place between entities that are controlled by the same controlling entity, but that entity is not the ultimate controlling entity of the economic entity. This has been accomplished by inserting the phrase “are controlled by the same entity.”

Preliminary View 2:

A **public sector combination under common control** is a public sector combination in which all of the entities or operations involved are controlled by the same entity or ultimately controlling entity both before and after the public sector combination.

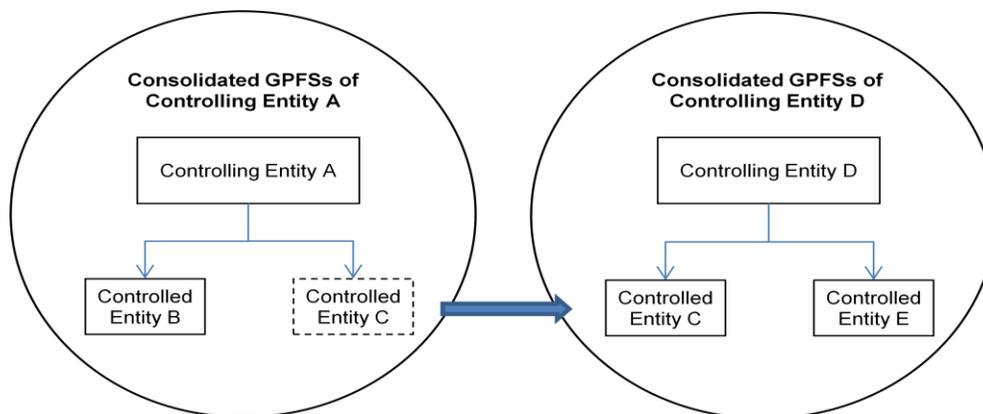
¹³ Paragraph B1 of Appendix B of IFRS 3.

The Parties to a PSC which are in the Scope of this CP

Acquisitions NUCC

- 2.27 This CP considers the accounting treatment in the GPFs of the entity that gains control of one or more operations (the recipient) in a PSC NUCC that meets the definition of an acquisition. Where the recipient is a controlling entity, GPFs means the consolidated GPFs of the economic entity.¹⁴ The CP does not deal with the accounting treatment in the separate financial statements¹⁵ (GPFs) of a controlling entity (where they are prepared), because IPSASs already include these requirements.¹⁶
- 2.28 The recipient in an acquisition NUCC could also be a single entity rather than an economic entity. Where the recipient in an acquisition NUCC is a single entity and the acquired operation is a component of an entity as opposed to an operation that is also an entity, GPFs means the individual GPFs of that single entity.
- 2.29 This CP does not deal with the accounting treatment in the GPFs of the entity that loses control of one or more operations (the transferor). Accrual-based IPSASs already include requirements on the accounting treatment in consolidated GPFs where a controlling entity loses control of a controlled entity.¹⁷ IPSASs do not specifically include requirements where an entity loses control of a component of an entity. However, IPSASs do include requirements for the derecognition of assets and the extinguishment of liabilities.
- 2.30 The parties to an acquisition NUCC can be illustrated as follows.

Diagram 1: Acquisition Involving Entities NUCC



¹⁴ IPSAS 6 defines consolidated financial statements as “the financial statements of an economic entity presented as those of a single entity.”

¹⁵ IPSAS 6 defines separate financial statements as “those financial statements presented by a controlling entity, an investor in an associate, or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct net assets/equity interest rather than on the basis of the reported results and net assets of the investees.”

¹⁶ Paragraph 58 of IPSAS 6.

¹⁷ These requirements are in IPSAS 6. Note, however, that the IPSASB does not have an equivalent standard to the IASB’s IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*, which has more detailed requirements relating to disposal groups and discontinued operations.

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- 2.31 Diagram 1 shows an acquisition NUCC involving Controlling Entity A and Controlling Entity D. Controlling Entity D (the recipient) gains control of Controlled Entity C from Controlling Entity A (the transferor). This CP considers the accounting treatment in the consolidated GPFSS of Controlling Entity D.

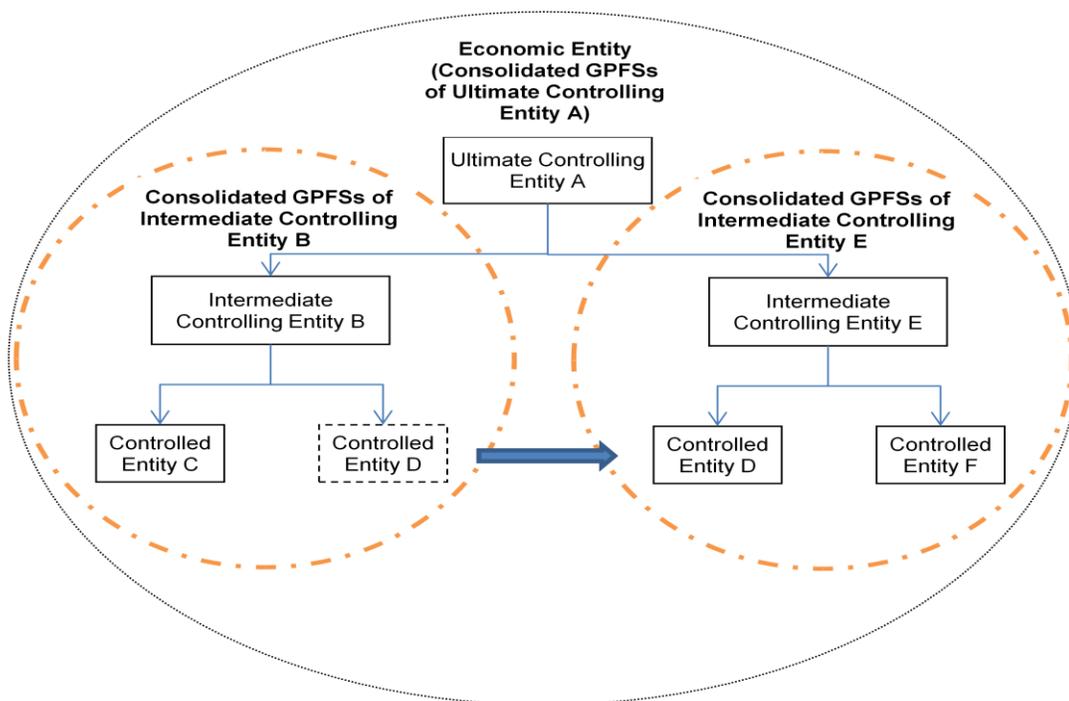
Acquisitions UCC

- 2.32 For an acquisition UCC, all the entities or operations involved in the acquisition are either within an economic entity or a single entity.
- 2.33 Where an acquisition takes place within an economic entity, the surpluses and deficits resulting from the acquisition are eliminated in full in the ultimate controlling entity's consolidated GPFSS.¹⁸ Therefore, this CP does not consider the accounting treatment in those financial statements. The CP considers the accounting treatment in the GPFSS of the recipient in an acquisition UCC. Where the recipient is a controlling entity, GPFSS means the consolidated GPFSS of that economic entity. In other words, in the intermediate controlling entity's consolidated GPFSS. The CP does not deal with the accounting treatment in the separate GPFSS of the intermediate controlling entity (where they are prepared), because IPSASs already include these requirements.
- 2.34 Where an acquisition UCC takes place within a single entity, in the same way as for an economic entity, the surpluses and deficits resulting from the acquisition are eliminated in full in the single entity's individual GPFSS, because there is no economic change in the single entity rather, operations have been transferred between parties within that entity. Therefore, this CP does not consider the accounting treatment in those financial statements. Because the acquisition UCC takes place within a single entity, the recipient's GPFSS will be the individual GPFSS of the lower level entity including the operation or operations that comprise the recipient.
- 2.35 In contrast with acquisitions NUCC, this CP also includes in its scope the accounting treatment of in the GPFSS of the entity that loses control of one or more operations (the transferor), because there is no economic change in the ultimate controlling entity's consolidated GPFSS (for acquisitions UCC taking place within an economic entity) or the GPFSS of the single entity (for acquisitions UCC taking place within a single entity).
- 2.36 The parties to an acquisition UCC can be illustrated as follows.

¹⁸ Paragraph 46 of IPSAS 6.

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Diagram 2: Acquisition Involving Entities UCC



2.37 Diagram 2 shows an acquisition UCC involving entities controlled by Ultimate Controlling Entity A. Intermediate Controlling Entity E (the recipient) gains control of Controlled Entity D from Intermediate Controlling Entity B (the transferor). This CP considers the accounting treatment in the consolidated GPFs of Intermediate Controlling Entity B and Intermediate Controlling Entity E.

Amalgamations NUCC and UCC

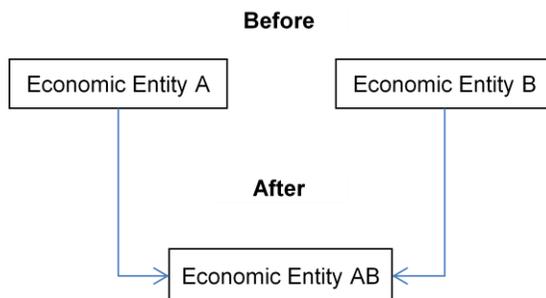
2.38 This CP considers the accounting treatment in the GPFs of the entity that is the result of the amalgamation (the resulting entity) NUCC and UCC. Where the resulting entity is an economic entity, GPFs of the resulting entity means the consolidated GPFs of that economic entity. Where the resulting entity is a single entity it is the individual GPFs of that entity.

2.39 Where an amalgamation takes place UCC within a single larger entity, i.e., UCC, GPFs of the resulting entity means the individual GPFs of the lower level entity which includes the operation or operations that comprise the recipient.

2.40 This CP also considers the accounting treatment in the financial statements of the combining operations where those operations continue to prepare and present GPFs in the period between the announcement of the amalgamation and the date the amalgamation takes place.

2.41 The parties to an amalgamation can be illustrated as follows.

Diagram 3: Amalgamation



- 2.42 Diagram 3 shows an amalgamation where Economic Entity A and Economic Entity B combine together to form Economic Entity AB. Entity A and Entity B are combining operations and Entity AB is the resulting entity. This CP considers (a) the accounting treatment in the consolidated GPFs of Entity AB at the date of the amalgamation, and (b) the accounting treatment in the consolidated GPFs of Entity A and Entity B in the period between the announcement of the amalgamation and the date the amalgamation takes place.
- 2.43 The structure of an amalgamation can differ depending on factors specific to each amalgamation, e.g., legislative requirements will vary across different jurisdictions and over time. The structure of an amalgamation may involve the formation of a new entity that receives the assets, liabilities, and net assets/equity of the combining operations. Alternatively, the structure of an amalgamation may not involve the creation of a new entity, and instead uses one of the combining operations as the resulting entity. This decision is a matter of the form of an amalgamation rather than its substance.

Government Business Enterprises

- 2.44 Where an acquisition involves a public sector entity gaining control of an operation that is a Government Business Enterprise (GBE),¹⁹ it is included in the scope of this CP because the CP discusses the accounting treatment for the recipient. Also included in the scope of the CP is the situation where one (or more) of the combining operations in an amalgamation is a GBE, because the CP discusses the accounting treatment for the resulting entity. The CP does not include in its scope the accounting treatment of a combination in the financial statements of a GBE, because GBEs do not apply IPSASs.²⁰

Summary

- 2.45 Table 1 below summarizes which parties to a PSC are in the scope of this CP. Note that these parties prepare and present GPFs in accordance with accrual-based IPSASs. Examples of the

¹⁹ IPSAS 1 defines a GBE as “An entity that has all the following characteristics:

- (a) Is an entity with the power to contract in its own name;
- (b) Has been assigned the financial and operational authority to carry on a business;
- (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
- (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length); and
- (e) Is controlled by a public sector entity.”

²⁰ Paragraph 12 of *Preface to International Public Sector Accounting Standards*.

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types of transactions and other events that give rise to a PSC that are included or excluded from the scope of this CP are set out Appendix B.

Table 1: Parties to a PSC in the Scope of this CP

	Acquisition			Amalgamation	
	Recipient	Transferor	Highest Level Entity ²¹	Resulting Entity	Combining Operations ²²
Definition	The entity that gains control of one or more operations	The entity that loses control of one or more of its operations to another entity in an acquisition	–	The entity that is the result of two or more operations combining where none of the combining operations gains control of the other operations	An operation that combines with one or more other operations to form the resulting entity
NUCC	Yes	No	Yes (but only to the extent that this CP includes consideration of the accounting treatment for goodwill)	Yes	Yes
UCC	Yes	Yes	No	Yes	Yes

Scope Exclusions

2.46 This CP excludes from its scope acquisitions of assets, the assumption of liabilities and the formation or acquisition of a joint venture. The reasons for their exclusion are dealt with below. The CP also does not deal with subsequent measurement, because IPSASs already include requirements on the subsequent measurement of assets, liabilities, and equity instruments issued (if any). Disclosures will focus on explaining the major characteristics of a PSC. Specific details will be developed to link with the accounting treatments proposed subsequent to reviewing of responses to the CP, because the accounting treatment needs to be further developed before disclosures can be given due consideration.

Acquisitions of Assets and Assumption of Liabilities

2.47 This CP excludes from its scope (a) acquisitions of assets, i.e., the gaining of control of an asset or a group of assets, and (b) the combining together of assets or groups of assets, where the acquisition or combining of the asset or group of assets does not also include related activities. This may occur where assets from several entities within an economic entity are transferred into a newly formed entity and the related activities remain in the existing entities, e.g., investment properties

²¹ For an economic entity, this will be the ultimate controlling entity's consolidated GPFs and for a single entity it will be the highest level entity's individual GPFs.

²² In the period between the announcement of the amalgamation and the date the amalgamation takes place.

are transferred into a newly formed entity and the management of these properties remains in the existing entities. IPSASs already include requirements for the accounting treatment of these types of transactions or other events.

- 2.48 Similarly, this CP also excludes from its scope the assumption of liabilities where that liability or those liabilities do not also include related activities, for the same reason given above for assets.

Formation of a Joint Venture

- 2.49 This CP excludes from its scope PSCs in which separate operations are brought together to form a joint venture.²³
- 2.50 The presentation of the formation of a joint venture in the financial statements of the venturers²⁴ is excluded from the scope of this CP because a venturer gains joint control²⁵ of a joint venture. The CP deals with an entity gaining control of one or more operations (acquisition) and two or more operations combining with none of the combining operations gaining control of the other operations (amalgamation). It does not deal with joint control. The presentation of a joint venture in the financial statements of the venturers is addressed in IPSAS 8, *Interests in Joint Ventures*. IPSAS 8 is being reviewed in the project on the *Revision of IPSASs 6–8*.
- 2.51 Accounting requirements for the formation of a joint venture in the financial statements of the joint venture itself are also excluded from the scope of this CP. The transaction or other event that results in the formation of a joint venture could be a PSC if two or more operations combine with none of the combining operations gaining control of the other operations. However, the concept underlying the formation of a joint venture differs from other combinations, in that the formation arises from separate entities deciding to share control, i.e., they have joint control of the operations that form the joint venture. The concept of joint control may give rise to issues that affect how the joint venture itself should account for its formation.
- 2.52 The definition of an amalgamation in this CP specifically excludes the formation of a joint venture.

Specific Matter for Comment 1:

In your view, is the scope of this CP appropriate?

Specific Matter for Comment 2:

In your view, is the approach to distinguish between acquisitions and amalgamations, with a further distinction for PSCs NUCC and PSCs UCC, appropriate? If you do not support this approach, what alternatives should be considered? Please explain your reasoning.

²³ IPSAS 8 defines a joint venture as “a binding arrangement whereby two or more parties are committed to undertake an activity that is subject to joint control.”

²⁴ IPSAS 8 defines a venturer as “a party to a joint venture and has joint control over that joint venture.”

²⁵ IPSAS 8 defines joint control as “the agreed sharing of control over an activity by a binding arrangement.”

3 The Boundary between Acquisitions and Amalgamations

- 3.1 The Introduction to this CP sets out some of the reasons why a PSC is undertaken. Generally, it is to achieve a more effective distribution of responsibilities and related activities or to deliver a greater volume or better quality of public goods or services. The CP reflects a view that the objective of a PSC can be achieved either by way of an acquisition or amalgamation. An amalgamation may be chosen because public sector entities, in contrast with profit-oriented entities, are not competing with each other to maximize returns to equity holders, and therefore are more likely to be involved in a combination in which no acquirer can be identified.
- 3.2 An example of when an amalgamation may occur is when it is imposed on one level of government by another level of government even though, for financial reporting purposes, that level of government does not control the other level of government. This is possible because some levels of government have a regulatory role to direct other levels of government in that jurisdiction. An amalgamation may also be undertaken voluntarily e.g., so that the combining operations are able to maintain the current level of services.
- 3.3 Section 2 defines an acquisition and an amalgamation as follows:
- “An **acquisition** is a transaction or other event that results in a recipient gaining control of one or more operations.”
- “An **amalgamation** is a transaction or other event where (a) two or more operations combine, (b) none of the combining operations gain control of the other operations, and (c) the transaction or other event is not the formation of a joint venture.”
- 3.4 Whether a PSC is classified as an acquisition or amalgamation depends on whether a recipient gains control of an operation (an acquisition), or none of the combining operations gain control of the other operations (an amalgamation).

Are there Other Factors to Consider in Distinguishing an Acquisition from an Amalgamation

- 3.5 A distinction between acquisitions and amalgamations is applied in some accounting standards dealing with combinations. This CP discusses how this distinction could be applied by reference to an international standard: IAS 22, *Business Combinations*, (issued in October 1998). IAS 22 distinguished between acquisitions and uniting of interests. IAS 22 was superseded by IFRS 3 in March 2004. IFRS 3 requires all business combinations to be accounted for as acquisitions, and therefore an acquirer must be identified for all business combinations.
- 3.6 IAS 22 described a uniting of interests as occurring only in exceptional circumstances, where it was not possible to identify an acquirer. 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 business combination had to be undertaken with a substantially equal exchange of shares between the shareholders of the combining entities.
- 3.7 In addition, the following three essential characteristics had to be met to qualify as a uniting of interests:
- (a) The substantial majority, if not all, of the voting common shares of the combining enterprises are exchanged or pooled;

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- (b) The fair value of one enterprise is not significantly different from that of the other enterprise; and
 - (c) The shareholders of each enterprise maintain substantially the same voting rights and interest in the combined entity, relative to each other, after the combination as before.
- 3.8 In assessing whether these characteristics could be applied to amalgamations in the public sector, it is immediately apparent that characteristics (a) and (c) relate to ownership instruments that public sector entities do not usually have.²⁶ These two characteristics also include the notion of an exchange of approximately equal values, so that the shareholders of the combining entities retain modified ownership instruments in the combined entity with approximately the same value as the value in the shareholding of one of the combining entities. The modification of ownership instruments reflects the purpose of a uniting of interests for profit-oriented entities, i.e., to improve the return on investment to shareholders of the combined entity.
- 3.9 In contrast, an amalgamation in the public sector does not usually involve an exchange of ownership instruments and there is no exchange of consideration. Therefore, characteristics (a) and (c) above do not appear relevant.
- 3.10 Characteristic (b) required the fair values of the combining entities to be relatively equal—the presumption being that if the combining entities are of different sizes, the largest entity could usually be identified as the acquirer. Does this reasoning apply in the public sector? Where an amalgamation is directed by another level of government, say by the enactment of legislation because it does not control the other 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.
- 3.11 Other characteristics present in a specific PSC could be used in helping to determine whether it meets the definition of an acquisition or an amalgamation. A characteristic that may be relevant in making this determination is the transfer of consideration. In acquisitions, consideration (an amount paid in cash or other assets) is usually transferred 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. However, many acquisitions in the public sector also occur without the transfer of consideration. Therefore, a lack of consideration may not be relevant in determining whether a PSC meets the definition of an acquisition or an amalgamation.
- 3.12 Another characteristic that may be considered to be relevant when making this determination is whether the PSC is imposed on one level of government by another level of government. If a PSC has been imposed, then it may indicate that it could be an amalgamation.
- 3.13 Other characteristics may include (a) whether one of the combining operations' to a PSC dominates the decision making processes or (b) whether one of the combining operations' appoints significantly more of the governing board of the resulting entity. The presence of either or both of these characteristics may indicate that the dominating combining operation has in fact gained control over the other combining operations, and therefore the combination would meet the definition of an acquisition. However, these characteristics may be similar in nature to a

²⁶ Phase 2 of the Conceptual Framework project on *Elements and Recognition in Financial Statements* is considering the issue of ownership interests more generally and how they relate to public sector entities.

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characteristic discussed above where it is presumed that the largest entity in a combination is the acquirer. This factor may not be relevant where a combination is imposed or directed as the relative size of the combining entities has little to do with the actions or intent of the combining entities. This reasoning may apply to the composition of the governing board and the decision making processes because the actions and intents of the combining entities does not relate to the reason why the combination is undertaken.

- 3.14 For the majority of PSCs, it will be immediately clear whether it is an acquisition or amalgamation, but for a small minority professional judgment will be necessary.

Preliminary View 3:

The sole definitive criterion for distinguishing an amalgamation from an acquisition is that, in an amalgamation, none of the combining operations gain control of the other operations.

Specific Matter for Comment 3:

In your view, are there other public sector characteristics that should be considered in determining whether one party has gained control of one or more operations?

4 Accounting for PSCs

Methods of Accounting

- 4.1 The following methods of accounting for combinations have been applied in practice or, in the case of the fresh start basis, discussed:
- (a) The acquisition method;
 - (b) The pooling of interests method, including a possible modification to this method; and
 - (c) The fresh start method.
- 4.2 A description of each method is set out below. This CP then considers, in Sections 5, 6, and 8, whether application of these methods is appropriate for accounting for PSCs.

The Acquisition Method

- 4.3 This CP describes the acquisition method as it is applied in IFRS 3, *Business Combinations*. IFRS 3 requires that an acquirer is identified for all business combinations, and therefore requires all business combinations to be accounted for using the acquisition method.
- 4.4 Under the acquisition method of accounting, one entity (the acquirer) obtains control of a business (the acquiree) from another entity in exchange for cash or other consideration. IFRS 3 requires the acquirer to recognize and measure the identifiable assets acquired and the liabilities assumed of the acquiree at their fair value at the date of acquisition. This requirement includes the recognition of identifiable assets and liabilities that may not have been previously recognized by the acquiree. Goodwill is measured indirectly as the excess of the aggregate of consideration transferred and the amount of non-controlling interests²⁷ (if any), over the acquisition date amounts of the fair value of the acquiree's net identifiable assets and liabilities. For example, an acquirer pays CU90 for an 80% interest in a business (the acquiree). The fair value of the identifiable assets and liabilities of the acquiree is CU100. The acquirer recognizes in its financial statements²⁸ identifiable net assets of the acquiree at CU100 and a non-controlling interest of CU20 (presented in equity). Goodwill is recognized at CU10 (CU90, being the consideration transferred plus the amount of non-controlling interests (CU20), over CU100, being the acquisition date amounts of the fair value of the acquiree's net identifiable assets and liabilities). If the fair value of the acquirer's share of the acquired identifiable assets and liabilities exceeds the consideration transferred, the acquirer recognizes a gain from a bargain purchase.

Recognition

- 4.5 Recognition relates to the process of incorporating an item that meets the definition of an element and can be measured reliably in the relevant financial statement. The acquisition method of accounting recognizes items arising from a business combination that meet the definitions of elements and are able to be reliably measured, as at the acquisition date, which is "the date on which the acquirer obtains control of the acquiree."²⁹

²⁷ Referred to as "minority interests" in IPSASs.

²⁸ "Financial statements" means the GPFSS of a single entity where it is an acquirer and consolidated GPFSS where the acquirer is a parent entity.

²⁹ Appendix A of IFRS 3.

Measurement—Fair Value

- 4.6 The acquisition method of accounting uses fair value as its measurement basis. The IPSASB 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.”^{30, 31}

- 4.7 This definition of fair value is applied in IPSASs as the amount that will be derived from an asset either from its use (service potential or economic benefits) or from its sale. Where there is market-based evidence of fair value, that value is used. Where there is no market-based evidence of fair value, it may be estimated by using a valuation technique or model, e.g., depreciated replacement cost.
- 4.8 The Measurement phase of the *Conceptual Framework* project may affect the definition and use of fair value.

Pooling of Interests Method

- 4.9 The pooling of interests method of accounting is intended for application to a business combination in which an acquirer cannot be identified. This CP describes the pooling of interests method as prescribed in IAS 22. IAS 22 was superseded by IFRS 3 in March 2004, which prohibited the use of the pooling of interests method.
- 4.10 The pooling of interests method of accounting is also known as the uniting of interests’ method of accounting or merger accounting.
- 4.11 IAS 22 specified that this method of accounting required the combined entity to recognize the assets, liabilities, and equity of the combining entities at their existing carrying amounts, adjusted only as a result of (a) aligning the combining entities’ accounting policies, and (b) applying those policies to all periods presented. There is no recognition of any new goodwill or negative goodwill as a result of the pooling of interests of the entities. For example, Entity A has recognized net assets of CU50 and Entity B has recognized net assets of CU40. Both entities have the same accounting policies. The combined entity recognizes net assets of CU90 and equity of CU90.
- 4.12 The pooling of interests method of accounting for business combinations was not included in IFRS 3 because the IASB was of the view that combinations where an acquirer could not be identified were so rare as not to warrant a separate accounting method, and was not convinced that if a different method was to be prescribed, it should be the pooling of interests method. Rather, the fresh start method was likely to be a superior method to the pooling of interests method. The IASB reasoning is set out in the Basis for Conclusions to IFRS 3.

³⁰ Paragraph 11 of IPSAS 9.

³¹ The definition of fair value in IPSAS 9 reflects that used in IFRSs at the time of issue of IPSAS 9. The IASB has recently completed its project on fair value measurement which has refined the definition of fair value. The amended definition 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).

Recognition

4.13 IAS 22 required that the pooling of interests method would recognize a uniting of interests by accounting for the combined entities as though the separate businesses were continuing as before, although now jointly owned and managed. The financial statement items 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 combined entities as if they had been combined from the beginning of the earliest period presented. In other words, the recognition point is the beginning of the earliest period presented, and, consequently, means that comparative information is restated. Therefore, the pooling of interests method of accounting results in recognition at an earlier date than either the acquisition method or the fresh start method (see below).

Possible Modification to the Point of Recognition

- 4.14 Some are of the view that the pooling of interests method could be modified to require the resulting entity to combine the items in the statement of financial position as at the date of the amalgamation. The surplus or deficit would then commence from the date of the amalgamation.
- 4.15 Where the pooling of interests method includes this modification to account for the amalgamation at the date of the amalgamation rather than as if the entities had always been combined, this CP refers to it as the “modified pooling of interests” method.

Measurement—Carrying Amount

4.16 The pooling and modified pooling of interests method of accounting uses the carrying amounts³² of items recognized in the financial statements of the combining entities, adjusted only to align the combining entities’ accounting policies, as its measurement approach. The carrying amount of the items in the statement of financial position will generally reflect different measurement bases because, for example, the entity (a) has some items that are required to be held at fair value, and other items that are required to be held at cost, and/or (b) has chosen options available under IPSASs to hold certain items at fair value while other items are held at cost. Because carrying amount is the amount presented in the statement of financial position, it is not a measurement basis as such, and so this CP refers to it as a “measurement approach.”

The Fresh Start Method

4.17 The fresh start method of accounting has been discussed for business combinations that meet the definition of a “uniting of interests.” In contrast to the pooling of interests method of accounting, the premise of the fresh start method is that the combined 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 recognition of all of the identifiable assets and liabilities of all the combining entities at fair value as at the date of the combination in the financial statements of the combined entity. This includes recognizing identifiable assets and liabilities that were not previously recognized by the combining operations. In other words, the fresh start method uses the same recognition and measurement basis as the acquisition method, but applies it to all of the combining entities rather than just the acquiree. For example, using Entities A and B from paragraph 4.11 above, i.e., Entity

³² The definitions of carrying amount in IPSASs are set out in Appendix A.

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A has recognized net assets of CU50 and Entity B has recognized net assets of CU40. However, the fair values of the identifiable recognized and unrecognized net assets are CU70 for Entity A and CU80 for Entity B. The resulting entity recognizes net assets of CU150 and equity of CU150.

Summary

4.18 Table 2 below summarizes the four methods of accounting.

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Table 2: Summary of Methods of Accounting

	Acquisition Method³³	Pooling of Interests Method³⁴	Modified Pooling of Interests Method³⁵	Fresh Start Method³⁶
Point of Recognition	On the date the acquirer gains control of the acquiree (the date of acquisition)	On the date which is the beginning of the earliest period presented	On the date of the combination	On the date of the combination
Measurement Basis or Approach	Remeasures the acquiree's identifiable assets and liabilities to fair value	Combining entities financial statement items are recognized without remeasurement at carrying amount, except where amounts are restated to align the accounting policies of the combining entities	Combining entities financial statement items are recognized without remeasurement at carrying amount, except where amounts are restated to align the accounting policies of the combining entities	Remeasures all the combining entities' identifiable assets and liabilities to fair value
Surplus or deficit in year of combination	The acquirer's surplus or deficit from beginning of reporting period and the acquiree's surplus or deficit from date of acquisition is recognized in the Statement of Financial Performance	All the combining entities' surplus or deficit from beginning of reporting period is recognized in the Statement of Financial Performance	The surplus or deficit from date of combination is recognized in the Statement of Financial Performance	The surplus or deficit from date of combination is recognized in the Statement of Financial Performance
Accumulated surplus or deficit	The acquirer's accumulated surplus or deficit and the acquiree's surplus or deficit from date of acquisition is recognized in net assets/equity	All the combining entities' accumulated surplus or deficit from beginning of reporting period is recognized in net assets/equity	Surplus or deficit commences from date of combination, so that accumulated surplus or deficit doesn't arise until the second reporting period	Surplus or deficit commences from date of combination, so that accumulated surplus or deficit doesn't arise until the second reporting period
Comparatives in the year of combination	Not restated	Restated	None	None
Consideration transferred	Can be cash or other assets including shares	Exchange of shares only	Exchange of shares only	Can be cash or other assets including shares

³³ In the GPFSS of the acquirer. Where the acquirer is a single entity, this means the individual financial statements, and where the acquirer is a parent entity, it means the consolidated GPFSS.

³⁴ In the GPFSS of the combined entity. Where the combined entity is a single entity, this means the individual financial statements, and where the combined entity is an economic entity, it means the consolidated GPFSS.

³⁵ In the GPFSS of the combined entity. Where the combined entity is a single entity, this means the individual financial statements, and where the combined entity is an economic entity, it means the consolidated GPFSS.

³⁶ In the GPFSS of the combined entity. Where the combined entity is a single entity, this means the individual financial statements, and where the acquirer is an economic entity, it means the consolidated GPFSS.

5 Accounting for Acquisitions not under Common Control (NUCC)

Introduction

- 5.1 The definition of an acquisition is “a transaction or other event that results in a recipient gaining control of one or more operations.” In an acquisition NUCC, a recipient gains control of one or more operations, and the recipient and transferor are not controlled by the same entity or ultimate controlling entity. This section of the CP focuses solely on accounting for acquisitions of operations that are NUCC. Accounting for acquisitions UCC is discussed in Section 6.
- 5.2 Section 4 of this CP describes the acquisition method of accounting for acquisitions. However, this Section does not directly analyze the application of the acquisition method to acquisitions because, for example, different approaches have been identified relating to the measurement basis or approach to adopt, which differ from the approach applied in the acquisition method. Therefore, this Section separately considers the following aspects of the accounting treatment for acquisitions:
- (a) When to recognize an acquisition;
 - (b) What is the appropriate measurement basis or approach?; and
 - (c) What is the appropriate treatment of the difference arising?
- 5.3 Table 3 on page 41 summarizes the options discussed for the measurement basis or approach to adopt and the possible accounting treatment of the difference arising.

When to Recognize an Acquisition

- 5.4 Recognizing an acquisition in the financial statements of the recipient on the date the recipient gains control of the acquired operation, i.e., the acquisition date, reflects the economic substance of the acquisition and is consistent with the acquisition method of accounting.

Preliminary View 4:

An acquisition NUCC should be recognized in the financial statements of the recipient on the date the recipient gains control of the acquired operation.

What is the Appropriate Measurement Basis or Approach?

- 5.5 The IPSASB has not reached a conclusion as to whether other features of the acquisition method of accounting, such as the use of fair value as the measurement basis, are appropriate for some or all acquisitions in the public sector. This is because the most prevalent types of acquisition is where operations are acquired for the achievement of objectives relating to the delivery of goods and/or services, instead of generating economic benefits to return to equity holders. Moreover, many acquisitions do not include the transfer of consideration. Some consider that these types of acquisitions are different in nature from business combinations as identified in IFRS 3, because the concept of acquiring an operation directly in exchange for the transfer of consideration is missing.
- 5.6 This sub-section explores whether different types of acquisitions should be distinguished, and whether fair value should be the measurement basis applied to all acquisitions, or only to some acquisitions, as follows:
- (a) Applying fair value measurement to the identifiable assets acquired and liabilities assumed in the operation at the date of acquisition for all acquisitions (Approach A); or
 - (b) Distinguish between different types of acquisitions (Approach B) so that:

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- (i) The carrying amounts of the assets and liabilities recognized in the acquired operation's financial statements are adopted, except where amounts are adjusted to align the operation's accounting policies with those of the recipient, at the date of acquisition, for acquisitions where no or nominal consideration is transferred; and
 - (ii) Fair value measurement is applied to the identifiable assets acquired and liabilities assumed in the operation at the date of acquisition for all acquisitions.
- 5.7 Some are of the view that adoption of fair value as the measurement basis achieves the objectives of financial reporting by public sector entities, and provides more useful information to users than the adoption of other measurement bases. However, others are of the view that using carrying amount also achieves the objectives of financial reporting by public sector entities, and is less costly to implement than applying fair value. The reasons for these views are explored further below.
- 5.8 The IPSASB notes that the future cash flows and service potential of the acquired operation will generally be the same regardless of the measurement basis or approach chosen. However, the recipient's subsequent presentation of financial performance and financial position will differ depending on the method applied.

Approach A: Use of Fair Value as the Measurement Basis for all Acquisitions

- 5.9 Those who advocate adoption of fair value as the measurement basis for the identifiable assets acquired and liabilities assumed in an acquired operation consider that it satisfies users' needs for information for accountability and decision making purposes. That is, it enables users to better assess whether the value of the consideration, if any, provided for the acquisition of an operation reflects the value of the net assets acquired.
- 5.10 The application of fair value is consistent with the measurement basis adopted in IPSASs when acquiring assets or incurring liabilities individually because:
- (a) The cost of acquiring assets (or incurring liabilities) individually in an exchange transaction reflects fair value³⁷ at the date of acquisition; and
 - (b) If the transaction to acquire an individual asset is a non-exchange transaction, IPSASs require the asset to be recognized and initially measured at fair value at the date of acquisition.
- 5.11 Therefore, using fair value enhances comparability³⁸ between acquisitions of individual assets and acquisitions of operations that have similar assets, because the measurement method is the same irrespective of the means by which those assets and liabilities are obtained.
- 5.12 Those who advocate adoption of fair value as the measurement basis consider that fair value meets the qualitative characteristic of relevance.³⁹ This is because (a) the recipient recognizes, and

³⁷ 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.

³⁸ Appendix A of IPSAS 1 describes the qualitative characteristic of comparability as: "Information in financial statements is comparable when users are able to identify similarities and differences between that information and information in other reports."

³⁹ Appendix A of IPSAS 1 describes the qualitative characteristic of relevance as:

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can be held accountable for, the current value of the resources it gains control of, and (b) information about the current value of those resources is useful input for accountability and decision making purposes. Fair value provides more relevant information to users than carrying amount because the use of fair value provides the current value of the assets that are used to achieve the recipient's objectives whether those objectives are to generate positive future cash flows, or deliver goods and services to constituents for no or nominal cost, or to achieve full cost recovery.

- 5.13 Furthermore, applying fair value as the measurement basis provides a faithful representation⁴⁰ of the consequences of an acquisition, because it requires the recipient to recognize in its financial statements the identifiable assets acquired and liabilities assumed, including those not previously recognized by the acquired operation before the acquisition.
- 5.14 Those who advocate adoption of fair value as the measurement basis argue that it is able to satisfy the other qualitative characteristics of financial reporting and the constraints on information included in GPFSSs. That is, the information would also need to be presented in a timely way and in a manner that is understandable. They acknowledge that in some cases it may be more costly to determine fair value than carrying amount, particularly where there is not a deep and liquid market for the assets, but note that IPSASs provide guidance on techniques that may be adopted for determining fair value in these circumstances.

Approach B: Potential Distinction between Acquisitions based on whether or not Consideration is Transferred

- 5.15 Some are of the view that the use of fair value as a measurement basis for all acquisitions in the public sector is not appropriate, because it does not result in a faithful representation when no or nominal consideration is transferred. Therefore, this CP explores a potential distinction between different types of acquisitions. This potential distinction is based on whether or not consideration is transferred and the CP considers two categories: (a) acquisitions where no or nominal consideration is transferred, and (b) acquisitions where more than nominal consideration is transferred⁴¹ (hereafter referred to as "consideration transferred"). Acquisitions where consideration is transferred may be somewhat rare in the public sector, but they do occur in practice. Therefore, a distinction between different types of acquisitions is required so that the appropriate accounting treatment can be applied.
- 5.16 The inclusion of the term "nominal" is to include acquisitions where a nominal amount is transferred. The transfer of a nominal amount of consideration may arise as part of the negotiation process in an acquisition. It may also arise where nominal consideration is transferred to satisfy the requirements in legislation or other regulation that an acquisition must include a transfer of consideration. Acquisitions where nominal consideration is transferred are considered to be similar in nature to those where no consideration is transferred, and thus are included in that category.

"Information is relevant to users if it can be used to assist in evaluating past, present, or future events or in confirming, or correcting, past evaluations. In order to be relevant, information must also be timely."

⁴⁰ Appendix A of IPSAS 1 describes the qualitative characteristic of faithful representation as:

"For information to represent faithfully transactions and other events, it should be presented in accordance with the substance of the transactions and other events, and not merely their legal form."

⁴¹ This distinction differs from the exchange transaction versus non-exchange transaction that was proposed in ED 41, because an exchange transaction can involve the transfer of no consideration where the value of the items being exchanged is equal.

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- 5.17 For acquisitions that involve the transfer of no or nominal consideration and net assets are acquired, the recipient effectively receives a gift or contribution from the transferor, even though some contributions may be involuntary when the acquisition is directed by another level of government. Where a recipient assumes net liabilities, the recipient effectively gives a gift or contribution to the transferor. And again, that contribution may be involuntary when the acquisition is directed by another level of government. The transfer of no or nominal consideration is a distinctive feature of many acquisitions, and it highlights the difference from acquisitions where consideration is transferred, which are predicated on the parties to an acquisition exchanging assets of similar values.

Acquisition where No or Nominal Consideration is Transferred

- 5.18 For an acquisition where no or nominal consideration is transferred, the recipient acquires an operation without fully compensating the transferor. Those who advocate a distinction between different types of acquisitions consider that, for these types of acquisitions, the recipient should recognize and measure the net assets acquired on the date of acquisition at the carrying amount recognized in the acquired operation's financial statements, except where amounts are adjusted to align the acquired operation's accounting policies with those of the recipient.
- 5.19 They believe that using carrying amount as a measurement approach satisfies users' needs for information for decision making purposes, and to assess the accountability of the entity for its use of those resources because users of public sector entities' financial statements are using the information to assess matters such as (a) how the financial resources have been allocated, and (b) how the financial condition of the entity has changed. This information can be obtained by using carrying amount and therefore those who advocate the use of carrying amount consider that it is appropriate to depart from the use of fair value as applied in the acquisition method of accounting. This contrasts with the information needs of users of profit-oriented entities financial statements, which use the information relating to a business combination to assess the markets' expectation of the value of the future cash flows associated with the acquired business.
- 5.20 Those who support this view consider a significant factor leading to decisions to undertake an acquisition where no or nominal consideration is transferred is the intent to reduce the cost of services through achievement of economies of scale or reduced administrative costs. Accordingly, initial recognition at the carrying amounts previously recognized by the pre-acquisition operations retains the same perspective on the reporting of those assets and liabilities.
- 5.21 Those who advocate the use of carrying amount consider it satisfies the qualitative characteristics of relevance and faithful representation, because it reflects the amounts recognized in the financial statements of the operation before it was acquired by the recipient. Thus, the subsequent performance of the recipient, i.e., its accountability for the management of these resources, may be assessed on the same basis as that used to assess accountability before the acquisition. It may also allow users to better assess trends and directions related to the performance of the acquired operation.
- 5.22 Those who advocate the use of carrying amount acknowledge that this measurement approach differs from the accounting treatment required by IPSASs for the acquisition of individual assets from non-exchange transactions. IPSASs require an asset from a non-exchange transaction to be recognized and initially measured at fair value at the date of acquisition. They consider that this difference in measurement basis is appropriate, because the acquisition of an operation results in the recipient acquiring an integrated set of activities and related assets and/or liabilities that is

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capable of being conducted and managed for the purpose of achieving the entity's objectives, by providing goods and/or services. The focus of this type of acquisition is on the integrated set of activities to which there are related assets and/or liabilities rather than on the individual assets acquired or liabilities assumed. The consequence of this difference in focus means that it is not necessary to require remeasurement on acquisition of an operation.

- 5.23 Lastly, those of this view consider that the balance between benefit and cost is met because using the existing carrying amount is almost always the least costly measurement approach to apply. It may also improve the timeliness of the preparation and presentation of GPFSSs, because the carrying amount of the net assets acquired is usually readily available.

Acquisition where Consideration is Transferred

- 5.24 Those who advocate distinguishing between (a) acquisitions where no or nominal consideration is transferred, and (b) acquisitions where consideration is transferred, believe that where an acquisition involves the transfer of consideration, this type of acquisition is similar in nature to a business combination because the recipient acquires an operation and compensates the transferor for the loss of control of that operation. Because the economic circumstances are similar, they consider that the measurement basis applied should be similar to that applied in the acquisition method of accounting, i.e., recognize and measure identifiable assets acquired and liabilities assumed at fair value.
- 5.25 The advantages of using fair value are the same as set out in Approach A, where it is proposed that fair value is the measurement basis for all acquisitions.

Specific Matter for Comment 4:

In your view, should the recipient in an acquisition NUCC recognize in its financial statements, the acquired operation's assets and liabilities by:

- (a) Applying fair value measurement to the identifiable assets acquired and liabilities assumed in the operation at the date of acquisition for all acquisitions (Approach A); or
- (b) Distinguishing between different types of acquisitions (Approach B) so that:
 - (i) The carrying amounts of the assets and liabilities recognized in the acquired operation's financial statements are adopted, except where amounts are adjusted to align the operation's accounting policies with those of the recipient, at the date of acquisition, for acquisitions where no or nominal consideration is transferred; and
 - (ii) Fair value measurement is applied to the identifiable assets acquired and liabilities assumed in the operation, at the date of acquisition, for acquisitions where consideration is transferred?

Please explain why you support Approach A or Approach B.

What is the Appropriate Treatment of the Difference Arising?

- 5.26 This sub-section explores the possible accounting treatments of the difference arising which is calculated as the difference between:
- (a) The consideration transferred (if any); plus

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- (b) The amount of any minority interest⁴² in the acquired operation (if any); minus
- (c) The amount of net assets acquired.

5.27 Where the recipient assumes net liabilities the difference arising is calculated as the total of the recipient's share of the net liabilities assumed, plus the amount (if any) of any minority interest in the acquired operation. The assumption of net liabilities does not involve the transfer of consideration.

Treatment of Difference Arising where Recipient Acquires Net Assets and No or Nominal Consideration is Transferred

5.28 Where the recipient acquires net assets and no or nominal consideration is transferred, the difference arising will result in an increase of the net assets/equity in the financial statements of the recipient during that reporting period. In other words, the recipient has received an economic gain representing an increase in economic benefits or service potential by the acquisition of an operation from the transferor.

5.29 The gain could be recognized directly in net assets/equity, or directly in surplus or deficit. IPSAS 1 defines net assets/equity as "the residual interest in the assets of the entity after deducting all its liabilities." IPSAS 1 envisages four components of net assets/equity. Those components include:

- (a) Contributed capital, being the cumulative total at the reporting date of contributions from owners, less distributions to owners;
- (b) Accumulated surpluses or deficits;
- (c) Reserves, including a description of the nature and purpose of each reserve within net assets/equity; and
- (d) Minority interests.

5.30 The nature of the economic gain is compared to the definitions of the components of net assets/equity listed in the previous paragraph:

- (a) Contributions from owners are defined as "future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which: (a) Conveys entitlement both to (i) distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to (ii) distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or (b) Can be sold, exchanged, transferred, or redeemed." A gain does not meet this definition because the transferor has not made a contribution to the recipient that results in a financial interest in the recipient by the transferor.
- (b) Accumulated surplus or deficit is an accumulation of an entity's past surpluses and deficits. A gain represents an individual transaction or other event and not an accumulation.
- (c) Reserves generally arise from items recognized directly in net assets/equity from specific requirements in IPSASs, and may include, for example, gains and losses on revaluation of

⁴² The accounting treatment of a minority interest is considered in Section 7.

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assets (e.g., property, plant, and equipment, investments). IPSASs currently do not specify the accounting treatment for PSCs, so there is no specific requirement relating to the treatment of the difference arising. Whether a gain should be required to be directly recognized in net/assets equity is discussed below.

- (d) A minority interest is defined 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.” A gain does not meet this definition, although an acquisition may involve minority interests.

5.31 Thus, a gain does not meet the definitions of three of the four components of net assets/equity. It could be accounted for as a component of reserves if an IPSAS specified that it should be recognized directly in net assets/equity. To consider whether a gain should be a component of reserves or revenue, it needs to be compared with the definition of revenue.

5.32 Revenue is defined as:

“The gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.”⁴³

5.33 The gain in an acquisition where no or nominal consideration is transferred is (in substance) a gross inflow of economic benefits or service potential during the reporting period, because the recipient has acquired net assets from the transferor. The inflow results in an increase in the net assets/equity of the recipient and does not meet the definition of a contribution from owners. Therefore, a gain meets the definition of revenue, and should be recognized in surplus or deficit (in the statement of financial performance) in the reporting period in which it occurs. Because a gain meets the definition of revenue, it should not be recognized directly in net assets/equity.

5.34 The IPSASB considers that the treatment of a gain is consistent with the requirement in IPSAS 23 that an inflow of resources from a non-exchange transaction is recognized as revenue.⁴⁴

Treatment of Difference Arising where Recipient Assumes Net Liabilities and No or Nominal Consideration is Transferred

5.35 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 incurred an economic loss by the acquisition of an operation from the transferor. Similar to the reasoning used above for the recognition of a gain, the 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 the acquisition on the recipient.

Treatment of the Difference Arising where Consideration Transferred is in Excess of Net Assets Acquired

5.36 IFRS 3 requires that the excess of the aggregate of consideration transferred and the amount of non-controlling interests (if any), and the acquisition date amounts of the fair value of the acquiree's net identifiable assets and liabilities be recognized as goodwill in the statement of financial position.

⁴³ Paragraph 7 of IPSAS 1.

⁴⁴ Paragraph 44 of IPSAS 23.

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- 5.37 The issue here is whether goodwill, as that term is used in IFRS 3, can exist in the public sector.
- 5.38 Existing IPSASs do not include a definition of goodwill or any requirements for its recognition and measurement. IFRS 3 defines goodwill as follows:
- “An asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognized.”
- 5.39 To put this definition into context, the IASB’s *Conceptual Framework* explains that the future economic benefits embodied in an asset relate to “the potential to contribute, directly or indirectly, to the flow of cash or cash equivalents to the entity.” This focus on future cash flows means that the excess of consideration transferred over the recipient’s interest in the net fair value of the acquired operation’s identifiable net assets in an acquisition in the public sector is unlikely to meet the definition of goodwill in IFRS 3, because the objectives of the majority of public sector entities are to provide goods and/or services to achieve their objectives rather than focusing on the generation of cash.
- 5.40 However, there may be rare circumstances where a recipient acquires a cash-generating operation, such as a GBE. Some consider that in this circumstance the definition of goodwill in IFRS 3 could be met, and therefore the excess should be recognized as goodwill (in the statement of financial position).
- 5.41 Alternatively, the IPSASB could develop a definition of goodwill (or a similar term) that encompasses the concept of service potential. The IPSASB’s current definition of an asset is 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.”⁴⁵
- 5.42 Some believe that the excess of consideration transferred over the fair value of the acquired operation’s identifiable net assets does meet the definition of an asset because the future service potential is represented by the future economies of scale and efficiencies that will arise from combining the recipient’s and the acquired operation’s net assets and operations. Those of this view consider that (a) goodwill can arise in an acquisition where consideration is transferred in the public sector, and (b) a definition of goodwill should be developed to encompass service potential related to an operation, rather than service potential just being reflected in individual assets.
- 5.43 Others argue that the excess of consideration transferred over the fair value of the acquired operation’s identifiable net assets does not meet the definition of an asset. Although it is a resource controlled by the recipient, it does not represent future economic benefits or service potential because it does not represent a resource that can be drawn on to provide services—only individual assets are able to provide services. In other words, service potential that is not capable of being individually identified and separately recognized does not arise. 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 with “cash-generating unit” in IPSAS 26, *Impairment of Cash-Generating Assets*) is unnecessary.

⁴⁵ Paragraph 7 of IPSAS 1.

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- 5.44 Those of this view consider that the excess does not meet the definition of an asset, and would therefore simply be a loss in surplus or deficit (in the statement of financial performance) in the reporting period in which it occurs. They consider that this information is relevant to users because it reflects the cost to the recipient for undertaking the acquisition. The loss also demonstrates that the recipient expended more resources to acquire the operation than is reflected in the amount of net assets acquired, and is therefore a faithful representation.

Treatment of the Difference Arising where Net Assets Acquired are in Excess of Consideration Transferred

- 5.45 IFRS 3 requires that where the fair value of the acquired identifiable assets and liabilities exceeds the consideration transferred, the acquirer recognizes a gain from a bargain purchase in profit or loss.
- 5.46 This situation is similar to circumstances in which a recipient acquires net assets and no or nominal consideration is transferred (see paragraphs 5.28–5.34), in that the recipient receives an economic gain. However, the gain is a net inflow of resources rather than a gross inflow of resources because consideration is transferred. In this situation, IPSASs⁴⁶ requires that the results of such transactions are presented by netting any revenue with related expenses arising on the same transaction when this presentation reflects the substance of the transaction or other event, e.g., gains and losses on the disposal of non-current assets. Therefore, a gain from an acquisition should be recognized in surplus or deficit (in the statement of financial performance) in the reporting period in which it occurs.

Summary

- 5.47 Table 3 below summarizes the options discussed above relating to the measurement basis or approach to adopt, and the accounting treatment of the difference arising in the financial statements of the recipient for an acquisition NUCC.

⁴⁶ Paragraph 50 of IPSAS 1.

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Table 3: Summary of Accounting Treatment of Acquisitions NUCC for the Recipient⁴⁷

	Approach A		Approach B			
			Acquisition where No or Nominal Consideration is Transferred		Acquisition where Consideration is Transferred	
Point of Recognition	The date the recipient gains control of the acquired operation (the date of acquisition)		The date the recipient gains control of the acquired operation (the date of acquisition)		The date the recipient gains control of the acquired operation (the date of acquisition)	
Measurement Basis or Approach	The recipient recognizes, in its financial statements, the acquired operation's identifiable assets and liabilities at fair value		The recipient recognizes, in its financial statements, the assets and liabilities that are recognized in the acquired operation's statement of financial position at carrying amount		The recipient recognizes, in its financial statements, the acquired operation's identifiable assets and liabilities at fair value	
Treatment of Difference Arising	Recipient acquires net assets in excess of consideration transferred (if any)	Gain from a bargain purchase	Recipient acquires net assets	Gain	Net assets acquired in excess of consideration transferred	Gain from a bargain purchase
	Recipient assumes net liabilities	Loss	Recipient assumes net liabilities	Loss	–	–
	Consideration transferred in excess of net assets acquired	Goodwill or Loss	–	–	Consideration transferred in excess of net assets acquired	Goodwill or Loss

⁴⁷ Where the recipient is a single entity, this means the individual GPFSSs, and where the recipient is a controlling entity, it means the consolidated GPFSSs.

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Preliminary View 5:

The recipient in an acquisition NUCC recognizes in its financial statements on the date of acquisition, the difference arising as:

- (a) A gain where the recipient acquires net assets in excess of consideration transferred (if any);
and
- (b) A loss where the recipient assumes net liabilities.

Specific Matter for Comment 5:

In your view, where the consideration transferred is in excess of the net assets acquired, should the difference arising in an acquisition NUCC (for both Approach A and Approach B, acquisitions where consideration is transferred) be recognized in the recipient's financial statements, on the date of acquisition, as:

- (a) Goodwill for acquisitions where the acquired operation is cash-generating and a loss for all other acquisitions;
- (b) Goodwill for all acquisitions (which would require development of a definition of goodwill that encompasses the notion of service potential); or
- (c) A loss for all acquisitions?

Please explain why you support (a), (b), or (c).

6 Accounting for Acquisitions under Common Control (UCC)

Introduction

- 6.1 Section 2 explains that the fundamental difference between acquisitions that are either a PSC UCC or a PSC NUCC is that the parties to an acquisition UCC are controlled by the same entity or ultimate controlling entity (hereafter referred to as “ultimate controlling entity”). This leads to economic differences between acquisitions NUCC and acquisitions UCC, as follows, for acquisitions UCC:
- (a) Acquisitions between entities within an economic entity do not change the economic resources of that economic entity;
 - (b) The surpluses and deficits resulting from the acquisition are eliminated in full in the ultimate controlling entity’s consolidated GPFs; and
 - (c) The ultimate controlling entity can specify whether any consideration is transferred.
- 6.2 These differences may have implications for the accounting treatment of an acquisition UCC.
- 6.3 IFRS 3 explicitly excludes business combinations under common control from its scope. In other words, there is no international guidance for profit-oriented entities on this topic. The European Financial Reporting Advisory Group (EFRAG) issued a Discussion Paper (DP), *Accounting for Business Combinations under Common Control (BCUCC)*, in October 2011.⁴⁸ EFRAG’s DP 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 applying IFRSs.
- 6.4 This Section also considers the accounting treatment for the loss of control of one or more operations from an acquisition in the transferor’s financial statements.

Recipient Accounting

When to Recognize an Acquisition

- 6.5 The IPSASB considers that an acquisition NUCC should be recognized in the financial statements of the recipient on the date the recipient gains control of the acquired operation, i.e., the acquisition date. The IPSASB considers that this is the appropriate point of recognition for acquisitions UCC, because the fact that the recipient and transferor are both controlled by the same ultimate controlling entity should not affect recognition of assets acquired or liabilities assumed.

Preliminary View 6:

An acquisition UCC should be recognized in the financial statements of the recipient on the date the recipient gains control of the acquired operation.

What is the Appropriate Measurement Basis or Approach?

- 6.6 The views as to whether carrying amount or fair value is the appropriate measurement basis or approach to apply in an acquisition NUCC have been outlined in Section 5. The reasoning underlying these views is substantially the same for acquisitions UCC.

⁴⁸ The DP is accessible on EFRAG’s website: www.efrag.org

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- 6.7 Those of the view that carrying amount is the appropriate measurement approach, consider that an additional reason supporting this view for acquisitions UCC is that the surpluses and deficits resulting from the acquisition are eliminated in full in the ultimate controlling entity's consolidated GPFs. They consider that because there has been no economic change in the overall economic entity, the recipient's financial statements should only recognize the assets and liabilities of the acquired operation that have already been recognized within the economic entity by the transferor. Therefore, remeasurement to fair value is inappropriate, because it implies that an economic gain has occurred, even though no economic change has occurred within the economic entity.
- 6.8 Alternatively, some are of the view that the measurement basis or approach to apply should be the same as that chosen for acquisitions NUCC, and this CP has not reached a conclusion as to which measurement basis or approach to apply. Proponents of this view point out that the accounting requirements in other IPSASs relating to transactions and other events does not distinguish between (a) transactions and other events that occur between entities within an economic entity, and (b) transactions and other events that occur between entities that have different ultimate controlling entities. Therefore, there is no reason for the accounting treatment of acquisitions to use this distinction.

Preliminary View 7:

The recipient in an acquisition UCC recognizes in its financial statements on the date of acquisition, the assets acquired and the liabilities assumed in one or more acquired operations, at carrying amount.

What is the Appropriate Treatment of the Difference Arising?

- 6.9 An acquisition UCC may include consideration. Section 5 concludes that a recipient in an acquisition NUCC should recognize in its financial statements, on the date of acquisition, the difference arising as:
- (a) A gain where the recipient acquires net assets in excess of consideration transferred (if any); and
 - (b) A loss where the recipient assumes net liabilities.
- 6.10 Section 5 does not conclude whether the difference arising where consideration is transferred in excess of net assets acquired is goodwill or a loss. Goodwill can only arise where consideration is transferred. Because the controlling entity or ultimate controlling entity can specify whether any consideration is transferred, and its amount, this option is not included in the following discussion.
- 6.11 An acquisition UCC does not have an effect on the consolidated financial statements of the ultimate controlling entity or the individual financial statements of a single entity. Whether or not this aspect of an acquisition UCC is relevant to the accounting treatment of the difference arising in the recipient's financial statements gives rise to possible alternative accounting treatments, as follows:
- (a) Gain or loss recognized in surplus or deficit (in the statement of financial performance);
 - (b) Contributions from owners or distributions to owners recognized directly in net assets/equity (in the statement of financial position); or
 - (c) Gain or loss recognized directly in net assets/equity (in the statement of financial position).

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Gain or Loss Recognized in Surplus or Deficit

- 6.12 Where the recipient acquires net assets, the difference arising will result in an increase of the net assets/equity during that reporting period. Some believe that this increase in net assets/equity is an economic gain and should be recognized in surplus or deficit (in the statement of financial performance) in the reporting period in which it occurs. The fact that the increase is eliminated in the ultimate controlling entity's consolidated GPFs⁴⁹ is not relevant, as the focus is on the GPFs of the recipient, and it has to account for an economic gain.
- 6.13 Proponents of this view point out that the accounting requirements in other IPSASs relating to transactions and other events does not distinguish between transactions and other events that occur between (a) entities within an economic entity, and (b) transactions and other events that occur between entities that have different controlling entities or ultimate controlling entities. As a consequence, IPSAS 6 requires that surpluses and deficits resulting from transactions within an economic entity are eliminated in full in the ultimate controlling entity's consolidated GPFs. Therefore, requiring a recipient to account for the difference arising as a gain is consistent with other IPSASs.
- 6.14 The same reasoning applies where a recipient assumes net liabilities, i.e., the difference arising will result in a decrease in the net assets/equity of the recipient and that decrease should be recognized in surplus or deficit (in the statement of financial performance).
- 6.15 Those of this view consider that the difference arising does not meet the definitions of contributions from owners or distributions to owners and that it is inappropriate to recognize a gain or loss directly in net assets/equity because the recipient has received a gain or incurred a loss.

Difference Arising Accounted for Directly in Net Assets/Equity

- 6.16 Those of the view that the accounting treatment of the difference arising should differ between an acquisition UCC and an acquisition NUCC (and also from the accounting requirements in other IPSASs) consider the fact that the acquisition has no effect on the consolidated financial statements of the ultimate controlling entity or the individual financial statements of a single entity is relevant. Therefore, any gain or loss arising from an acquisition UCC should not be recognized by the recipient in its surplus or deficit for the reporting period.
- 6.17 Therefore, two alternatives for the accounting treatment of the difference arising are explored below.

Contributions from Owners or Distributions to Owners

- 6.18 The determination of whether the difference arising from an acquisition UCC can be a contribution from owners (where the recipient acquires net assets) or a distribution to owners (where the recipient assumes net liabilities) is based on the definitions of contributions from owners and distributions to owners. These are defined as follows:

Contributions from owners means future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that

⁴⁹ Where the recipient is an operation in a single entity, this means the individual financial statements of that operation, and where the recipient is a controlling entity, it means the consolidated GPFs.

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result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:

- (a) Conveys entitlement both to
 - (i) Distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to
 - (ii) Distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or
- (b) Can be sold, exchanged, transferred, or redeemed.

Distributions to owners means future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.

- 6.19 Some believe that the difference arising from an acquisition UCC automatically meets these definitions, because the recipient and transferor are controlled by the same ultimate controlling entity. Thus, this is seen as a transaction with owners.
- 6.20 Proponents of this view consider that the gain (where the recipient acquires net assets) meets the definition of a contribution from owners because the acquired net assets have been contributed to the recipient by a party external to it, the transferor. Because both the recipient and the transferor are controlled by the ultimate controlling entity, the ultimate controlling entity has changed its financial interest in the net assets/equity of the recipient and the transferor as a result of the acquisition. The effect of the acquisition is to increase the ultimate controlling entity's financial interest in the recipient, and the recipient should recognize the difference arising as a contribution from owners.
- 6.21 Where a recipient in an acquisition UCC assumes net liabilities, those of this view consider that the loss meets the definition of a distribution to owners, because the recipient has distributed some of its net assets/equity. The effect of this on the ultimate controlling entity is to decrease its financial interest in the net assets/equity of the recipient.
- 6.22 Those of this view consider that it is inappropriate for the difference arising to be recognized as a gain or loss in surplus or deficit, because it meets the definitions of contributions from owners or distributions to owners.

Gain or Loss Recognized in Directly Net Assets/Equity

- 6.23 The difference arising on an acquisition UCC could be recognized directly in net assets/equity. Some believe that this is the appropriate treatment of a difference arising, because they consider that the difference arising does not meet the definitions of contributions from owners or distributions to owners. They consider that the fact the surpluses or deficits resulting from the acquisition are eliminated in full in the ultimate controlling entity's consolidated GPFs is relevant and, consequently, it is not appropriate for the difference arising to be recognized in surplus or deficit, because the ultimate controlling entity can specify whether any consideration is transferred. This has a direct effect on the amount of the gain or loss and therefore it should not be recognized in surplus or deficit.
- 6.24 Moreover, those of this view consider that the difference arising could only meet the definitions of contributions from owners or distributions to owners where the acquisition is undertaken between

the ultimate controlling entity and a controlled entity. In other words, the ultimate controlling entity must be the transferor.

- 6.25 Proponents of this view acknowledge that this accounting treatment of the difference arising would need to be a specific requirement in any resulting IPSAS because it creates a new component of net assets/equity.⁵⁰

Specific Matter for Comment 6:

In your view, should the recipient in an acquisition UCC recognize in its financial statements, on the date of acquisition, the difference arising as:

- (a) A gain or loss recognized in surplus or deficit (in the statement of financial performance);
- (b) A contribution from owners or distribution to owners recognized directly in net assets/equity (in the statement of financial position); or
- (c) A gain or loss recognized directly in net assets/equity (in the statement of financial position), except where the transferor is the ultimate controlling entity and recognized as a contribution from owners or distribution to owners?

Please explain why you support (a), (b), or (c).

Transferor Accounting

- 6.26 This sub-section is included in the CP because two of the alternatives for the accounting treatment of the difference arising in the recipient's GPFs would result in asymmetrical accounting treatment between the recipient and the transferor within an economic entity. This is due to the fact that IPSAS 6 includes requirements where a controlling entity loses control of a controlled entity, irrespective of how control is lost, and hence these requirements apply to a transferor.
- 6.27 IPSAS 6 requires that the difference between the proceeds from disposal (if any) and the controlled entity's carrying amount at the date of disposal is recognized in the consolidated statement of financial performance as a gain or loss on disposal of a controlled entity.
- 6.28 IPSAS 6 also includes accounting requirements where a controlling entity retains an interest in the formerly controlled entity. IPSAS 6 requires that, from the date the controlled entity ceases to be a controlled entity, it is accounted for according to the accounting standard that applies to the type of interest retained. For example, where a formerly controlled entity becomes an investment, IPSAS 29, *Financial Instruments: Recognition and Measurement*, applies.
- 6.29 IPSASs do not specifically include requirements where an entity loses control of a component of an entity. However, IPSASs do include requirements for the derecognition of assets and the extinguishment of liabilities.
- 6.30 These accounting requirements reflect that IPSASs do not distinguish between (a) transactions and other events that occur between entities within an economic entity, and (b) transactions and other events that occur between entities that have different ultimate controlling entities. If it is proposed that the recipient recognizes in its GPFs, on the date of acquisition, the difference arising as gain

⁵⁰ The reasons why the difference arising is not a component of the other components of net assets/equity is set out in paragraph 5.30, and they apply equally to acquisitions UCC.

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or loss in surplus or deficit (in the statement of financial performance), then the accounting treatment between the recipient and the transferor would be symmetrical, or a “mirror image.”

- 6.31 However, if it is proposed that the recipient recognizes in its GPFs, on the date of acquisition, the difference arising as either (a) a contribution from owners or distribution to owners, or (b) as a separate component of net assets/equity, then the accounting treatment between the recipient and the transferor would not be symmetrical.

Specific Matter for Comment 7:

In your view, should the accounting treatment for the recipient and transferor of an acquisition UCC be symmetrical?

7 Accounting for Acquisitions—Other Issues

7.1 The purpose of this section is to briefly explore the following issues:

- (a) The presence of minority interests;
- (b) Acquisition-related costs; and
- (c) Subsequent accounting for goodwill.

Presence of Minority Interests

7.2 The discussion in Sections 5 and 6 does not consider an acquisition where less than 100% of the ownership instruments are obtained by the recipient. This sub-section considers situations where a recipient gains control of less than 100% of the acquired operation, and can apply to both acquisitions NUCC and acquisitions UCC.

7.3 The portion of ownership instruments that do not relate to the controlling entity is termed a “minority interest.” A minority interest is defined as follows:

“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.”

Effect of a Minority Interest on the Difference Arising

7.4 Where the recipient acquires net assets and no consideration is transferred, 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 arising. Where the net assets acquired are in excess of the consideration transferred, a minority interest decreases the amount of difference arising. Where the recipient assumes net liabilities, the presence of a minority interest has the effect of decreasing the amount of the recognized loss.

Measurement of a Minority Interest

7.5 A minority interest can be measured at either:

- (a) Fair value; or
- (b) The minority interests’ proportionate share of the acquired operation’s net assets.⁵¹

7.6 Where an acquired 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 at the date of acquisition. Where an active market price is not available, fair value will need to be estimated using a valuation technique.

7.7 Some consider that for acquisitions where the measurement approach applied to the acquired operation’s assets and liabilities is carrying amount, it seems contradictory to measure a minority interest at fair value. However, where an acquired operation’s assets and liabilities are measured at fair value, it seems sensible to apply the same measurement basis to minority interests. For

⁵¹ The accounting treatment of minority interests is based on the requirements for non-controlling interests in IFRS 3, and that Standard gives acquirers a choice of measurement bases.

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acquisitions NUCC, Section 5 does not come to a conclusion as to whether the measurement basis or approach for an acquired operation's assets and liabilities should be (a) fair value for all acquisitions, or (b) carrying amount for those acquisitions where no consideration is transferred. For acquisitions UCC, Section 6 concludes that carrying amount is the appropriate measurement approach.

- 7.8 Therefore, for at least acquisitions UCC, the measurement basis for the minority interest should be measured at the proportionate share of the acquired operation's net assets. The question is then whether a choice of measurement basis should be permitted for those acquisitions NUCC where the measurement basis for the acquired operation's assets and liabilities is fair value.
- 7.9 Some consider that giving preparers a choice of accounting treatment for minority interests is likely to decrease the comparability of the recipients' financial statements. They consider that (a) all minority interests should use the same measurement basis, and (b) because minority interests in acquisitions UCC should be measured at the proportionate share of the acquired operation's net assets, this basis should also be applied to acquisitions NUCC.
- 7.10 The IPSASB considers that the alignment of measurement basis between the acquired operation's assets and liabilities and its minority interest is appropriate. It also considers that there should not be a choice of measurement basis for the minority interest where the measurement basis for the acquired operation's assets and liabilities is fair value, because it reduces comparability. Consequently, minority interests should be measured at the proportionate share of the acquired operation's net assets.

Preliminary View 8:

A minority interest should be measured as a proportionate share of the acquired operation's net assets.

Acquisition-Related Costs

- 7.11 Acquisition-related costs are the costs a recipient incurs to effect the acquisition and can be incurred for both acquisitions NUCC and acquisitions UCC. Examples of acquisition-related costs include legal, accounting valuation and other professional and consulting fees, and costs to issue debt or equity securities.⁵²
- 7.12 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 costs.⁵³ The measurement on initial recognition of an asset from a non-exchange transaction is fair value at the date of acquisition.
- 7.13 One view is that acquisition-related costs are not part of the cost of acquisition of the acquired 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

⁵² IFRS 3 requires that the costs incurred by an acquirer to effect a business combination 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 the relevant financial instruments standards.

⁵³ For example, investment property (IPSAS 16.28), property, plant, and equipment (IPSAS 17.30), and intangible assets (IPSAS 31.34).

assets at the date of acquisition because the benefits have already flowed to the recipient from the services received.

- 7.14 Those of this view consider that, because the measurement basis or approach applied to the acquired operation's assets and liabilities is not the cost basis (it is either carrying amount or fair value), it is appropriate to apply a different accounting treatment to acquisition-related costs arising from acquisitions from that required by other IPSASs for the acquisition of other assets.
- 7.15 Another view is that acquisition-related costs meet the definition of an asset because they are directly attributable to the acquisition of the acquired operation. That the cost basis is not used for the measurement basis for the acquired 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 operation. Those of this view consider that acquisition-related costs should be recognized as an asset in the statement of financial position.

Preliminary View 9:

Acquisition-related costs should be an expense in surplus or deficit (in the statement of financial performance) in the period in which the services are received.

Subsequent Accounting for Goodwill

- 7.16 Section 6 discusses acquisitions UCC and concluded that goodwill does not arise for this type of acquisition. Therefore, subsequent accounting for goodwill relates only to acquisitions NUCC. Section 5 discusses acquisitions NUCC, and does not come to a conclusion as to whether goodwill exists in the public sector. The following discussion will apply if it is determined that goodwill does meet the definition of an asset. The potential accounting treatment for goodwill after its initial recognition needs to be considered, because IPSASs currently do not specify the accounting treatment for goodwill.
- 7.17 This CP considers two alternatives:
- (a) Non-amortization with an impairment test annually or more frequently if events or changes in circumstances indicate that it might be impaired (the current accounting treatment in IFRSs);
or
 - (b) Amortization on a systematic basis over its useful life (the accounting treatment required by IAS 22 before it was superseded by IFRS 3).
- 7.18 IAS 36, *Impairment of Assets*, requires the acquirer to test goodwill for impairment annually, or more frequently if events or changes in circumstances indicate that it might be impaired. IAS 36 also requires the goodwill arising from a business combination in the current period to be tested for impairment before the end of the current annual period. The IASB's rationale for the impairment testing of goodwill was that more useful information could be provided to users if goodwill was not amortized, but instead tested for impairment annually, because it was unlikely that an amortization expense would reflect the consumption of acquired goodwill when the internally generated goodwill replacing it was not recognized and so would not be useful to users.⁵⁴

⁵⁴ Paragraphs BC131E and BC131G of the Basis for Conclusions for IAS 36.

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- 7.19 Alternatively, IAS 22 required that goodwill be amortized on a systematic basis over its useful life, and included a rebuttable presumption that its useful life would not exceed twenty years from initial recognition. If that presumption was rebutted, goodwill was required to be tested for impairment at least at each financial year end.
- 7.20 Proponents of the IAS 22 approach consider that acquired goodwill is consumed and replaced with internally generated goodwill and its amortization ensures that acquired goodwill is recognized in profit and loss and no internally generated goodwill is recognized as an asset in its place. They also consider that this approach is consistent with the approach taken for other intangible assets with finite lives, because the amortization of goodwill allocates its cost over the periods in which it is consumed.
- 7.21 Irrespective of which alternative is chosen, the impairment test used in existing IPSASs will need to be reviewed to ensure its compatibility with proposed requirements relating to goodwill.

Specific Matter for Comment 8:

If it is determined that goodwill does meet the definition of an asset in the public sector, in your view, should the subsequent accounting of goodwill be:

- (c) Non-amortization, with an impairment test annually or more frequently if events or changes in circumstances indicate that it might be impaired;
- (d) Amortization on a systematic basis over its useful life; or
- (e) Another approach?

Please explain why you support (a), (b), or (c).

8 Accounting for Amalgamations

Introduction

- 8.1 The definition of an amalgamation is “a transaction or other event where (a) two or more operations combine, (b) none of the combining operations gain control of the other operations, and (c) the transaction or other event is not the formation of a joint venture.” This Section applies to both amalgamations NUCC and amalgamations UCC.

Resulting Entity—What is the Appropriate Method of Accounting?

- 8.2 Section 4 of this CP describes three methods of accounting for amalgamations. They are (a) the pooling of interests method, (b) the modified pooling of interests method, and (c) the fresh start method. The use of carrying amount or fair value as a measurement approach or basis is not separately discussed, because the pooling and modified pooling of interests method uses carrying amount and the fresh start method uses fair value.

Analysis

- 8.3 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 presentation of the financial performance and financial position of the resulting entity, and changes therein as a result of the amalgamation and its consequential activities, differs significantly depending on the method applied. If preparers are given a free choice of method, this would reduce comparability between entities and over time.
- 8.4 The advocates of the use of the pooling or modified pooling of interests method of accounting for amalgamations consider that these methods satisfy users' needs (a) for information for decision making purposes, and (b) to assess the accountability of the resulting entity for its use of resources. This is because users of public sector entities' GPFs are using the information to assess matters such as how the financial resources have been allocated and the financial condition of the entity. This information can be obtained by applying the pooling or modified pooling of interests method of accounting.
- 8.5 Those who support this view consider that these methods satisfy the qualitative characteristics of relevance and faithful representation, because they reflect the amounts recognized in the financial statements of the combining operations before the amalgamation. Thus, the subsequent performance of the resulting entity, and its accountability for the management of those resources, may be assessed on the same basis as was used to assess accountability before the amalgamation.
- 8.6 Those who advocate use of the pooling or modified pooling of interests methods of accounting consider that these methods are almost always the least costly to apply, because they (a) use the existing carrying amounts of the assets, liabilities, and net assets/equity of the combining operations, and (b) do not require identifying, measuring, and recognizing assets or liabilities not previously recognized before the amalgamation.
- 8.7 Those who advocate the application of the modified pooling of interests method of accounting over the pooling of interests method consider it to be superior, because it portrays the amalgamation as it actually is, by recognizing the financial statement items of the combining operations at the date of

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the amalgamation in the resulting entity's GPFSSs. They consider that this is a faithful representation of the amalgamation rather than portraying the combining operations as if they had always been combined.

- 8.8 Those who support the use of the modified pooling of interests method acknowledge that the history of the combining operations may help in assessing the performance of the resulting entity. They consider that one method to ensure that users can easily access this information is to require the presentation of "pro-forma" information for the combining 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 operations.
- 8.9 Alternatively, others are of the view that the fresh start method of accounting is conceptually superior to both the pooling of interests method of accounting and its modified version, because resulting entity is held accountable for the current value of the resources of the combining operations, and it provides more complete information of the amalgamation because it recognizes the identifiable assets and liabilities of the combining operations, regardless of whether they were recognized prior to the amalgamation.
- 8.10 Those of this view consider the fresh start method of accounting satisfies users' needs (a) for information for decision making purposes, and (b) to assess the accountability of the resulting entity for its use of resources, because it enables users to better assess the financial condition of the entity and how the financial resources have been allocated.
- 8.11 Moreover, those who support the fresh start method of accounting consider that this method is, to a large extent, an extension of the use of fair value in the acquisition method of accounting. Consequently, if the acquisition method is adopted for acquisitions, there is no reason not to adopt it for amalgamations. Those who support the use of the fresh start method acknowledge that this approach would need to be further developed, e.g., determining where to recognize the difference arising from the remeasurement of the assets and liabilities of the combining operations, 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 acquisition method, and thus would not be onerous.
- 8.12 The IPSASB is of the view that the modified pooling of interests method of accounting is the appropriate method to apply because users' are able to assess the performance and accountability of the resulting entity without the entity having to remeasure its assets and liabilities. Furthermore, it recognizes the amalgamation on the date it takes place. The IPSASB has been able to reach this view because it considers that amalgamations are a homogeneous set of transactions or other events, whereas the IPSASB has not formed on the appropriate accounting treatment for acquisitions because the types of acquisitions may vary significantly. The IPSASB notes that IPSASs permit revaluation to fair value subsequent to initial recognition if a resulting entity considers that this approach would provide more information to users.⁵⁵

Preliminary View 10:

A resulting entity in an amalgamation should apply the modified pooling of interests method of accounting.

⁵⁵ For example, property, plant, and equipment and investment properties.

Accounting Treatment in the Combining Operations in the Period Leading up to the Amalgamation

- 8.13 Where the combining operations continue to prepare and present GPFs using accrual-based IPSASs in the period between the announcement of the amalgamation and the date of the amalgamation, guidance is required as to how to continue to apply accrual-based IPSASs. This guidance is necessary because the process to achieve an amalgamation may cover more than one reporting period. The issue here is then this: should these financial statements be prepared on a going concern basis?
- 8.14 IPSAS 1⁵⁶ requires that financial statements are prepared on a going concern basis⁵⁷ (a) unless there is an intention to liquidate or to cease operating, or (b) if there is no realistic alternative but to do so. Some are of the view that the fact the combining operations will cease to exist on the date of the amalgamation may affect the basis of preparation of the financial statements, and may suggest that the financial statements should not be prepared on a going concern basis.
- 8.15 However, an alternative view is that a presumption can be made that the resulting entity will continue to undertake the same activities as the combining operations, because the resulting entity needs to fulfill the responsibilities it has assumed from the combining operations. Accordingly, the combining 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.

Preliminary View 11:

Where combining operations continue to prepare and present GPFs using accrual-based IPSASs in the period between the announcement of the amalgamation and the date of the amalgamation, these are prepared on a going concern basis where the resulting entity will fulfill the responsibilities of the combining operations.

⁵⁶ Paragraph 38 of IPSAS 1.

⁵⁷ The assumption underlying the going concern basis is that the entity will continue in operation and meets its statutory obligations for the foreseeable future.

Appendix A: Proposed and Existing Definitions

Proposed Definitions

Term	Definition	Paragraph reference in this CP
Acquisition	A transaction or other event that results in a recipient gaining control of one or more operations.	2.11
Amalgamation	A transaction or other event where (a) two or more operations combine, (b) none of the combining operations gain control of the other operations, and (c) the transaction or other event is not the formation of a joint venture.	2.17
Combining operation	An operation that combines with one or more other operations to form the resulting entity.	2.18
Entity	An entity (for the purposes of this CP) is a public sector organization which comprises one or more operations.	2.3
Operation	An integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services.	2.5
Public sector combination	The bringing together of separate operations into one entity, either as an acquisition or an amalgamation.	2.1
Public sector combination under common control	A public sector combination in which all of the entities or operations involved are controlled by the same entity or ultimate controlling entity both before and after the public sector combination.	2.23
Recipient	The entity that gains control of one or more operations.	2.14
Resulting entity	The entity that is the result of two or more operations combining where none of the combining operations gains control of the other operations.	2.18
Transferor	The entity that loses control of one or more of its operations to another entity (the recipient) in an acquisition.	2.14

Existing Definitions

Term	Definition	Paragraph reference in Existing IPSASs	Paragraph reference in this CP
Asset	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	1.7	5.41
Carrying amount (of an intangible)	The amount at which an asset is recognized after deducting any accumulated amortization and accumulated impairment losses.	31.16	4.16

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Term	Definition	Paragraph reference in Existing IPSASs	Paragraph reference in this CP
asset)			
Carrying amount (of investment property)	The amount at which an asset is recognized in the statement of financial position.	16.7	4.16
Carrying amount (of property, plant, and equipment)	The amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.	17.13	4.16
Carrying amount of a liability	The amount at which a liability is recognized in the statement of financial position.	10.7	4.16
Carrying amount of an asset	The amount at which an asset is recognized in the statement of financial position, after deducting any accumulated depreciation and accumulated impairment losses thereon.	10.7	4.16
Consolidated financial statements	The financial statements of an economic entity presented as those of a single entity.	6.7	2.27
Contributions from owners	<p>Future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:</p> <p>(a) Conveys entitlement both to (i) distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to (ii) distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or</p> <p>(b) Can be sold, exchanged, transferred, or redeemed.</p>	1.7	5.30 and 6.18
Control	The power to govern the financial and operating policies of another entity so as to benefit from its activities.	2.8	2.12
Controlled entity	An entity, including an unincorporated entity such as a partnership, which is under the control of another entity (known as the controlling entity).	6.7	2.20
Controlling entity	An entity that has one or more controlled entities.	6.7	2.20
Distributions to owners	Future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.	1.7	6.18
Economic entity	A group of entities comprising a controlling entity and one or more controlled entities.	1.7	2.20
Exchange transactions	Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.	9.11	1.4

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Term	Definition	Paragraph reference in Existing IPSASs	Paragraph reference in this CP
Fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.	9.11	4.6
Government Business Enterprise	An entity that has all the following characteristics: (a) Is an entity with the power to contract in its own name; (b) Has been assigned the financial and operational authority to carry on a business; (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery; (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and (e) Is controlled by a public sector entity.	1.7	2.44
Joint control	The agreed sharing of control over an activity by a binding arrangement.	8.6	2.50
Joint venture	A binding arrangement whereby two or more parties are committed to undertake an activity that is subject to joint control.	8.6	2.49
Minority interest	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.	6.7	5.30 and 7.3
Net assets/equity	The residual interest in the assets of the entity after deducting all its liabilities.	1.7	5.29
Non-exchange transactions	Transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.	9.11	1.4
Revenue	The gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.	1.7	5.32
Separate financial statements	Those financial statements presented by a controlling entity, an investor in an associate, or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct net assets/equity interest rather than on the basis of the reported results and net assets of the investees.	6.7	2.27
Venturer	A party to a joint venture and has joint control over that joint venture.	8.6	2.50

Appendix B: Examples of the Scope of this Consultation Paper

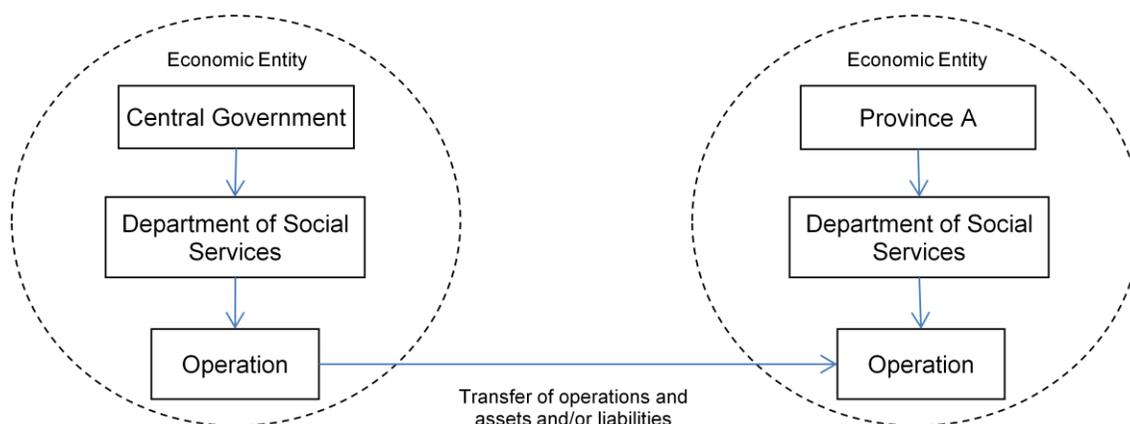
B1. Set out below are examples of the scope of this CP.

Acquisition NUCC

B2. Where the recipient and transferor are not part of the same economic entity, the acquisition is NUCC. This CP includes in its scope the accounting treatment in the financial statements of the recipient, i.e., the entity or operation that gains control of one or more operations.

B3. An acquisition NUCC can be illustrated as follows.

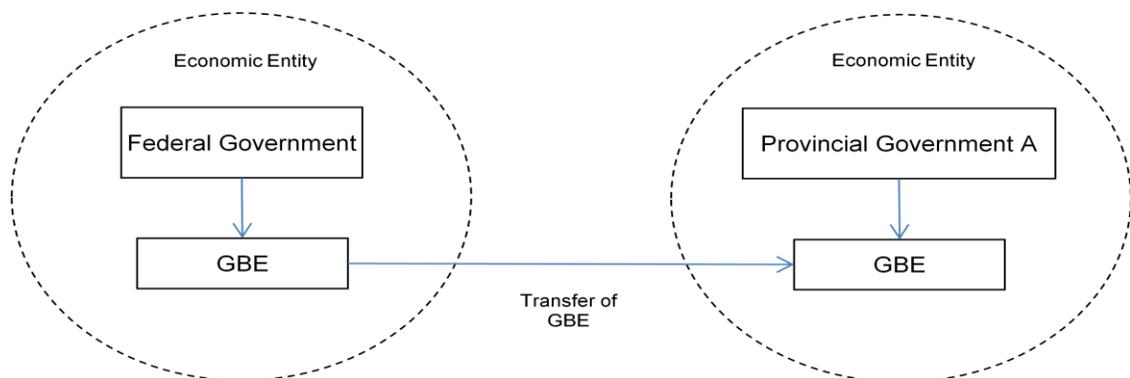
Diagram 1: Acquisition NUCC



B4. Diagram 1 illustrates an acquisition between entities that are NUCC. The Department of Social Services of the Central Government transfers an operation to the Department of Social Services of Province A, which is not controlled by the Federal government. The Department of Social Services of Province A is the recipient and the Department of Social Services of the Central Government is the transferor. Province A prepares and presents GPFSSs.

B5. An acquisition NUCC that involves a GBE can be illustrated as follows.

Diagram 2: Acquisition NUCC involving a GBE



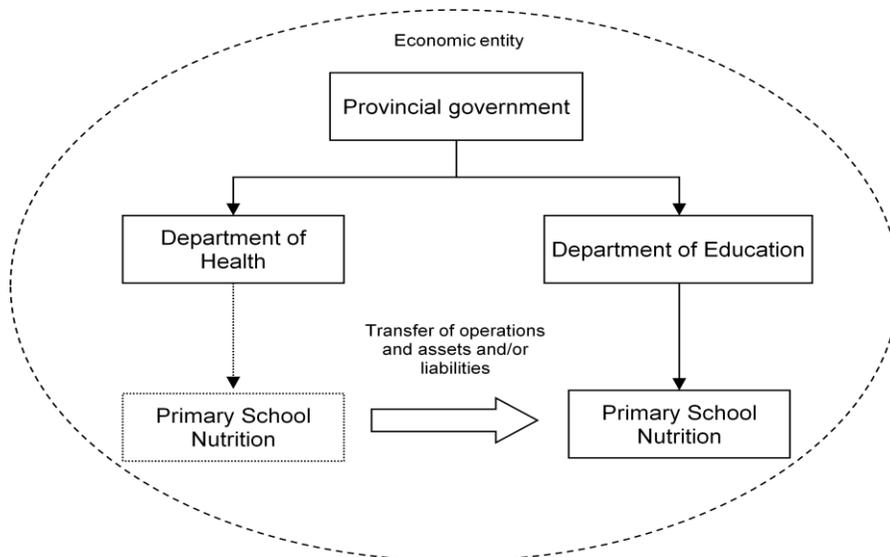
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- B6. Diagram 2 illustrates an acquisition involving a GBE between entities that are NUCC. Provincial Government A (the recipient) gains control of a GBE from the Federal Government (the transferor). Provincial Government A prepares and presents GPFSSs.

Acquisition UCC

- B7. Where the recipient and transferor are part of the same economic entity, the acquisition is UCC. This CP includes in its scope the accounting treatment in the financial statements of the recipient and the transferor. This can be illustrated as follows.

Diagram 3: Acquisition UCC

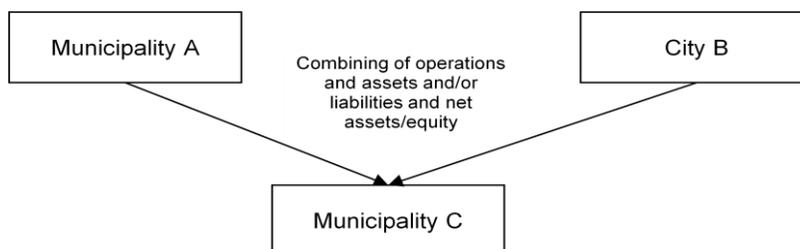


- B8. Diagram 3 illustrates an acquisition between entities that are UCC. The Department of Education gains control of the Primary School Nutrition operation from the Department of Health. The Department of Education is the recipient and the Department of Health is the transferor. Both departments prepare and present GPFSSs.

Amalgamation NUCC

- B9. An amalgamation may take different forms and may or may not involve the formation of a new entity for the resulting 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.

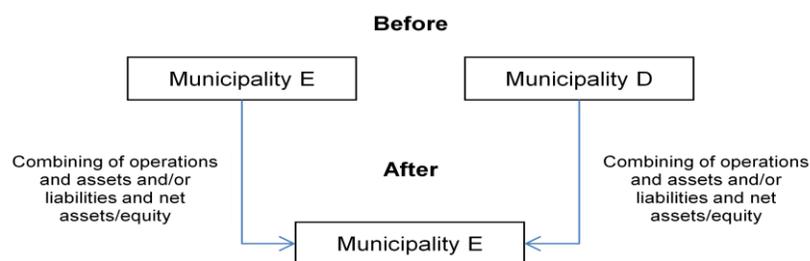
Diagram 4: Amalgamation NUCC using the Formation of New Entity



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B10. Diagram 4 above illustrates an amalgamation where Municipality C is formed to combine the operations and related assets and/or 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 operations. After the amalgamation, Municipality A and City B cease to exist. Municipality C prepares and presents GPFs. Municipality A and City B continue to prepare and present GPFs until the date of the amalgamation.

Diagram 5: Amalgamation NUCC using an Existing Combining Operation

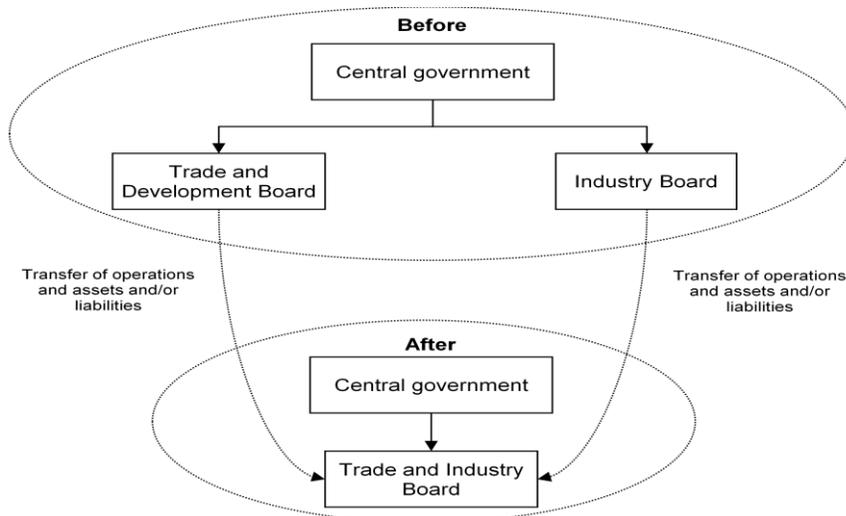


B11. Diagram 5 above illustrates an amalgamation where Municipality D and Municipality E combine, and they use the entity that is Municipality E before the amalgamation to combine the operations and related assets and/or liabilities and net assets/equity on amalgamation. This amalgamation was undertaken at the direction of the central government by the enactment of legislation— however, 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 operations, so the resulting entity is named Municipality E. Municipality D and Municipality E before the amalgamation are the combining operations. Municipality E (after the amalgamation) prepares and presents GPFs. Municipality D and Municipality E (before the amalgamation) continue to prepare and present GPFs until the date of the amalgamation.

Amalgamation UCC

B12. An amalgamation may take place UCC as follows.

Diagram 6: Amalgamation UCC

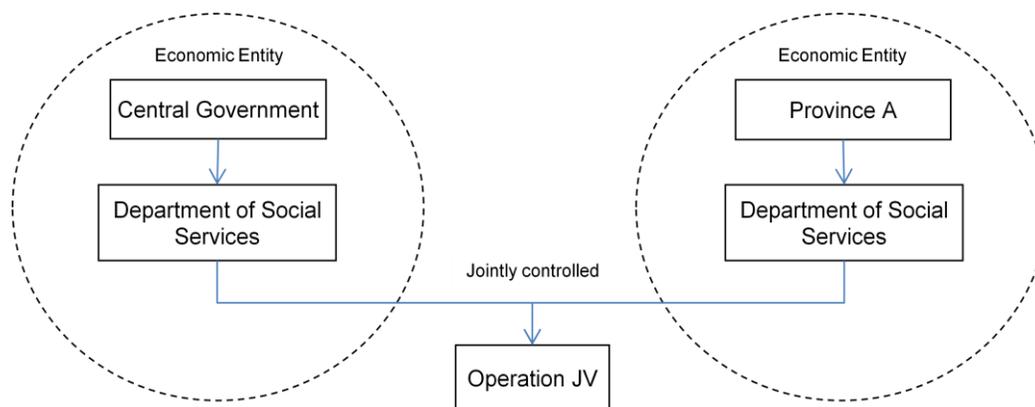


B13. Diagram 6 illustrates an amalgamation where a Central government restructures two of its operations, the Trade and Development Board and the Industry Board, by combining their operations and related assets and/or liabilities and net assets/equity in a newly formed government operation, the Trade and Industry Board. The structure of the Central government is that of a single entity. The Trade and Development Board and the Industry Board are the combining operations and the Trade and Industry Board is the resulting operation. The Trade and Industry Board prepares and presents GPFs. The Trade and Development Board and the Industry Board continue to prepare and present GPFs until the date of the amalgamation.

Formation of a Joint Venture

B14. This example illustrates a transaction that is outside the scope of this CP. The Departments of Social Services of Central Government and Province A decide to form a joint venture (Operation JV) by entering into a binding arrangement where they are committed to undertake an activity which is under their joint control. This situation is illustrated below.

Diagram 7: Formation of a Joint Venture



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Appendix C: Public Sector Combinations Flow Chart

