

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Toronto, Canada

Meeting Date: December 8-11, 2014

Agenda Item 8

For:

☐ Approval

☒ Discussion

☐ Information

Public Sector Combinations

Objective(s) of Agenda Item

1. The objective of this session is to **review** an Issues Paper on Public Sector Combinations; and to **provide directions** on the development of an IPSAS on public sector combinations.

Material(s) Presented

Agenda Item 8.1 Issues Paper, *Public Sector Combinations*

2. The detailed analyses of the responses to the Preliminary Views and the Specific Matters for Comment were presented at the June 2014 meeting and are not duplicated in this agenda item. Members wishing to review the analyses are referred to the June 2014 meeting papers.

Action(s) Requested

3. The IPSASB is asked to **consider the issues** raised in the Issues Paper and to:
 - (a) **Agree** the approach to classifying public sector combinations UCC;
 - (b) **Agree** the related definitions;
 - (c) **Agree** the accounting treatments to be applied to different classes of combinations;
 - (d) **Confirm** that the formation of joint ventures is outside the scope of this project;
 - (e) **Decide** on the terminology to be used in a future IPSAS; and
 - (f) **Agree** the presentation objective and the approach to disclosure in a future IPSAS.

Issues Paper, *Public Sector Combinations***Introduction**

1. At its September 2014 meeting, the IPSASB agreed that:
 - (a) The primary distinction between public sector combinations is between those combinations under common control (UCC) and those not under common control (NUCC).
 - (b) Combinations UCC would be classified as reorganizations¹ and accounted for using a form of the pooling of interests method by default. Exceptionally, combinations UCC would be accounted for using the acquisition method where this reflects the substance of the combinations
 - (c) Combinations NUCC would be classified as either acquisitions or amalgamations.
 - (d) Additional guidance on determining control would be provided (for example, consideration, exchange, commercial substance, market prices, voluntary or involuntary nature of the combination).
 - (e) Staff should undertake additional work regarding a change in sector, taking into account changes of ownership, changes of control and the reporting entity level.
 - (f) The exclusion of joint ventures would be reviewed in December 2014 meeting.
2. The IPSASB directed staff to:
 - Prepare the rationale to support the proposed primary distinction between combinations UCC and combinations NUCC;
 - Undertake additional work on the change of sector (considering whether a change of economic entity, change of control and/or change of ownership are also relevant); and
 - Discuss the reporting entity level for accounting of PSC.
3. This Issues Paper also considers:
 - The accounting treatments to be used for each class of combinations;
 - The measurement to be used for each class of combinations;
 - The terminology to be used when describing combinations; and
 - Presentation requirements in respect of combinations.

Classification

4. At the September 2014 meeting, staff proposed that all public sector combinations UCC should be considered a single class of combinations. The IPSASB generally supported this approach, but considered that there may be exceptions where a combination UCC may have the economic

¹ This terminology is discussed in paragraphs 247 - 249 of the Issues Paper

substance of an acquisition. The IPSASB directed staff to develop the rationale to support this approach. This is discussed in the following paragraphs.

Distinction between combinations UCC and combinations NUCC

5. An economic entity comprises a controlling entity and one or more controlled entities. The economic entity may have several operations. The entities and operations can be seen as resources of those who own and/or control them.
6. Sometimes the existence of several entities inside of an economic entity instead of one entity having all operations as divisions can be for legal requirements rather than for economic reasons. The economic environment of these entities are similar to a division inside of an entity. The managers of these entities/divisions are not autonomous in their decisions when they manage their operations. They implement the decisions taken by the managers of the controlling entity.
7. Combinations UCC are combinations within the same economic entity. The economic environment of entities UCC, as described in paragraphs 5-6, can also be applied when there is a combination of controlled entities.
8. The top managers of the controlling entity can decide how the combinations of operations between different entities/divisions should be made. When these types of combinations occur, they may be seen as internal bookkeeping to reflect changes in intermediate responsibility for particular operations by entities within the same economic entity.
9. However, the ultimate responsibility about the performance and financial position over the combined entities rests only upon the managers of the controlling entity. In other words, the risks and rewards associated with management of the resources lies upon the same ultimate controlling entity.
10. The controlled entities involved in a combination UCC do not act independently, rather they are directed by the controlling entity. This includes the form of the combination and the level of consideration transferred, if any. In this type of combination, the combined entities/operations will remain under the same ownership and control nature of the controlling entity after the combination.
11. The level of ownership and control has the strictest nature in this type of combinations. It is as if every entity/operation would be managed under a single command and, therefore, the form of the combination does not matter, because everything would be equal in terms of ownership and control after the combination.
12. Differently, combinations NUCC are combinations made between independent parties. The parties in a combination NUCC are different economic agents responsible for the management of the resources that they own and/or control and seek to converge into a deal starting from opposing positions.

Reorganizations

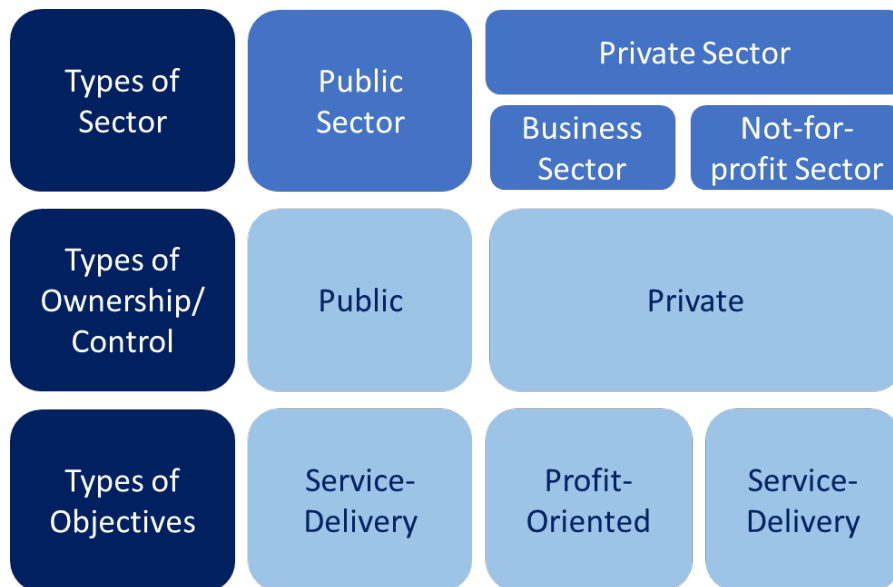
13. Therefore, a combination of resources that occurs within the same economic entity can have a different economic nature than a combination that does not occur within the same economic entity. Staff is of the view that making the first distinction of PSC according to the UCC/NUCC dichotomy will enable the identification of the first type of PSC.
14. In this Issues Paper, staff refer to the type of combinations UCC described above as *reorganizations*, which was the name IPSASB used at its September 2014 meeting. The Reorganizations section

proposes a definition of a reorganization and proposes consequential amendments to the acquisition definition to avoid overlaps.

Distinction between combinations NUCC

15. At the September 2014 meeting the IPSASB requested staff to do further research on the change of sector and ownership.
16. Entities in different sectors have different economic natures, including the nature of their ownership and their objectives. For example, *The Preface to the Conceptual Framework for General Purpose Reporting by Public Sector Entities* highlights a number of unique features of public sector entities such as the right to levy taxes. The key differences between sectors are illustrated in the diagram below:

Figure 1: Differences between Sectors:



17. Because they have different natures, a combination of entities from different sectors can never be a merger of equals (the underlying concept behind amalgamations) and so must be either an acquisition or a joint venture.

Amalgamations

18. Therefore, amalgamations (or true mergers of equals) can only occur within the public sector where the new entity that is created to receive the operations from the combining entities still has the same economic nature. Staff is of the view that analyzing the features of transactions from the perspectives of both parties is necessary to determine what type of combination has occurred.
19. According to *The Preface to the Conceptual Framework for General Purpose Reporting by Public Sector Entities* (Preface) "The primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a return on equity to investors."
20. In the public sector some entities lack the type of ownership interest that business entities have and, therefore, are more focused on improving service delivery than maximizing returns for equity holders.

21. At its September 2014 meeting, the IPSASB agreed that public sector combinations that included an exchange (whether the items exchanged are of approximately equal value or not) were acquisitions. It follows that amalgamations are always public sector combinations in which there is no exchange between the parties.
22. In an amalgamation, the new entity (the resulting entity) is created or emerges as a result of the combination with no economic link to the combining entities.
23. In other words, a true merger of equals is where none of the public sector combining entities retain ownership and/or control link over the operations that they surrender to a new entity. This new entity cannot be considered an acquirer because it has no economic relationship with the combining entities in the transaction except to receive the operations. The new entity did not participate in the arrangement of the combination, did not exchange any value to receive the operations, nor has any ownership/control link to the combining entities.
24. Staff is of the view that, when two public sector entities without ownership interests (e.g., municipalities) combine by creating a newly formed entity, where the combining entities are extinguished and neither ownership or control link exists over the newly formed entity, it is the “truest merger of equals” because the combined entities no longer have an influence over the resources they previously owned and/or controlled.
25. This Issues Paper refers to the type of combinations NUCC as described above as *amalgamations*. The section Amalgamations develops in more detail their nature and definition.

Acquisitions

26. As discussed above, amalgamations have a different economic nature from acquisitions that also occur in combinations NUCC.
27. In an acquisition there is a change in control of resources from one entity to another entity. In other words, the risks and rewards associated with the entities’ resources change as a result of the transaction.
28. There are several sub-types of acquisitions, covering both exchange and non-exchange transactions.
29. The most usual type of acquisitions happens in the business sector. When one entity (the acquirer) buys resources from another entity (the seller) compensates the seller for the transfer of those resources. This can be considered a market acquisition where the participants in the transaction have different objectives: the seller wants to maximize the price it obtains for ceding ownership and control over the resources and the acquirer wants to minimize the price it incurs to obtain ownership and control over the resources.
30. This type of transaction is an exchange transaction. As it occurs commonly in the business sector, respondents to the CP refer to this type of transaction as a *commercial transaction* or to the transaction having *commercial substance*. Through the exchange the sellers cede ownership and control over the resources and the purchasers gain ownership and control over the resources and give approximately equal value (consideration) in the form of cash, goods, services or use of assets to the sellers.
31. The existence of consideration is viewed as a compensation from the buyer to the seller for the resources that latter surrenders to the former. The existence of consideration in a transaction at market prices is conclusive of an acquisition.

32. This type of transaction can also occur in the public sector. For example, central government can sell assets to a municipality or two municipalities can agree to exchange assets.
33. However, it is possible to have acquisitions even though it is not an exchange transaction, i.e., with consideration at market prices. For example:
 - (a) Bargain purchases where there is no or nominal consideration;
 - (b) Donations from private sector entities or individuals to public sector entities;
 - (c) Uncompensated seizure of assets (i.e. a forced nationalization);
34. There is also the case where there is no consideration because the transaction reflects the fair value of the resources or one entity assumes the net liabilities of another entity. In this case, it can be argued that it is an exchange transaction.
35. The distinction between acquisitions that do not involve an exchange and amalgamations that do not involve an exchange is that, in an acquisition, the entity that receives the operations (the recipient) already exists. In an amalgamation, the entity that received the operations (the resulting entity) is created as a result of the combination.
36. Sometimes gaining (legal) ownership equals gaining control, but this might not always be the case. For example, acquisitions can also occur through contractual arrangements where one party gains control of the operations and/or entity without ownership rights being transferred.
37. The common thread in all these examples is one entity gaining control of resources from another entity in a transaction between unrelated parties. Therefore, staff is of the view that the two essential features of an acquisition are:
 - (a) One party gaining control over resources; and
 - (b) The parties to the transaction act independently.
38. As with amalgamations, staff is of the view that analyzing the features of transactions from the perspectives of both parties is necessary to determine whether an acquisition has occurred.
39. Staff acknowledges that these two features may need to be supplemented with other factors in order to identify more sub-types of acquisitions. For example, it is possible to have acquisitions even in transactions UCC (where the ultimate controlling entity is the same), provided the parties act independently, as it was acknowledged by IPSASB at the September 2014 meeting.
40. The section below about Acquisitions develops in more detail the nature and definition of acquisitions and the relationship between gaining ownership and gaining control.
41. Staff considers that this section already provides a conceptual basis for proposing separate classifications for amalgamations and acquisitions and, therefore, answers concerns raised by respondents to the CP in this area:
 - (a) Respondents 3, 8 and 13 consider that the CP does not sufficiently address public sector issues because it focuses on acquisitions of a commercial nature.
 - (b) Respondent 13 considers that the CP does not adequately describe amalgamations, which the respondent considers to be more common than acquisitions in the public sector.

- (c) Respondents 6 and 19 do not support the distinction between acquisitions and amalgamations. They do not consider that the CP provides a conceptual basis or specific public sector reasons to depart from the approach in IFRS 3.

Amendments to CP definitions of public sector combination and operation

42. Staff proposes the following definition of a public sector combination:

A **public sector combination** is a transaction or other event in which brings together separate operations into one entity, other than the formation of a joint venture.

43. The CP definition of public sector combination is:

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

44. Staff added the words “is a transaction or other event” because the reorganization, amalgamation and acquisition (see below) definitions will include the term “public sector combination”. This means that a public sector combination is always be the result of a transaction or other event in which brings together separate operations into one entity. This avoids the need to repeat “transaction or other event” in other definitions. What may change is the context in which the public sector combination is made.

45. This change also addresses the necessity to distinguish reorganizations (as a public sector combination) from restructurings, which is a defined term in other IPSASs that covers a wider range of transactions than a public sector combination.

46. Staff deleted the words either as an “amalgamation or an acquisition” for simplification reasons because reorganizations is now a new type of public sector combinations and it will enlarge the definition without any value added.

47. This proposal is aligned with the suggestion of respondent 23: “The definition requires the forthcoming IPSAS to be applied to all types of PSCs. The words “either as an acquisition or an amalgamation” are not needed in the definition of a PSC as “the bringing together of separate operations into one entity” would encompass all types of combinations.”

48. The exclusion of joint ventures is discussed later in this Issues Paper. Staff notes that in the CP the exclusion of joint ventures was included in the amalgamation definition. If this exclusion is not moved to the definition of a public sector combination, it would be necessary to repeat it in the definition of a reorganization.

49. An alternative approach, not adopted in the CP, would be to omit the exclusion from the definitions but to address this in the scope section of a future IPSAS.

50. Staff proposes the following definition of an operation:

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, either by providing goods and/or services or by providing a return to owners.

51. The CP definition of public sector combination is:

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, either by providing goods and/or services.

52. Staff added the words "or by providing a return to owners" because it may be possible where, as a result of a PSC, government receives operations that generate a return to owners. For example, a nationalization of a private sector corporation.

Matter(s) for Consideration

1. The IPSASB is asked **to indicate** whether it agrees with staff's proposals that:
 - (a) A **public sector combination** is a transaction or other event in which brings together separate operations into one entity, other than the formation of a joint venture.
 - (b) 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, either by providing goods and/or services or by providing a return to owners.

Reorganizations

Definition

53. As a result of the analysis in paragraphs 5-14, staff proposes the following definitions:

A **reorganization** is a public sector combination under common control that does not meet the definition of an acquisition.

A **reorganization** is a public sector combination (...)

54. Staff included the term "public sector combination" because reorganizations are only to include combinations of operations. In this way, avoids any eventual overlapping with the term restructuring where might not include combination of operation.

(...) under common control (...)

55. Staff added the term "under common control" to reflect IPSASB decision in September 2014 meeting, that reorganizations only occur UCC.

(...) that does not meet the definition of an acquisition.

56. A PSC UCC will meet the definition of an acquisition where:

- One entity gains control of operations; and
- The parties to the transaction act independently (i.e., without being directed or influenced by a controlling entity or other related party).

57. Staff proposes three more definitions within the context of reorganizations to identify the parties and the part involved in the combinations:

A **reorganized entity** is an entity that loses control of one or more of its operations to a receiving entity in a reorganization;

A **receiving entity** is the entity that receives one or more operations in a reorganization;

A **reorganizing operation** is an operation that combines with one or more other operations in a reorganization to form the receiving entity;

58. Staff is of the view that the identification of the parties in a reorganization favors clarification and consistency between the different types of combinations. If the parties and the part in acquisitions and amalgamations are distinguished with different names, then the parties and the part in a reorganization should also be defined. In this way it also favors the drafting of the future standard because each type of combination would have its own terminology.

Matter(s) for Consideration

2. The IPSASB is asked **to indicate** whether it agrees with staff's proposals that:
- (a) A **reorganization** is any public sector combination under common control, other than a combination that does not meet the definition an acquisition.
 - (b) A **reorganized entity** is an entity that loses control of one or more of its operations to a receiving entity in a reorganization;
 - (c) A **receiving entity** is the entity that receives one or more operations in a reorganization;
 - (d) A **reorganizing operation** is an operation that combines with one or more other operations in a reorganization to form the receiving entity;
 - (e) A PSC UCC will meet the definition of an acquisition where:
 - One entity gains control of operations; and
 - The parties to the transaction act independently (i.e., without being directed or influenced by a controlling entity or other related party).

Amendments to CP definition of an acquisition

59. Staff is of the view that the CP definition of an acquisition may overlap with the reorganization definition. For example, the current definition of an acquisition would include the scenario where a department moves from being controlled by one ministry to being controlled by another ministry. This type of combination would meet the definition of an acquisition (a recipient gaining control of one or more operations).
60. To avoid this kind of overlaps, staff suggests the acquisition definition should include a reference that the combination should be between parties acting independently.
61. The proposed change reflects prior staff's view that analyzing the features of transactions from the perspectives of both parties is necessary to determine whether an acquisition has occurred.

Amalgamations

Definition

62. As a result of the analysis in paragraphs 18 - 25, staff proposes the following definitions:
- An **amalgamation** is a public sector combination not under common control where (a) two or more operations within the public sector combine to form a new entity, (b) no consideration is transferred, and (c) no remaining entity retains control or shared control over the resulting entity;

A **remaining entity** is an entity that loses control of one or more of its operations to the resulting entity in an amalgamation, without gaining any shared control over that entity;

A **resulting entity** is the new entity that is the result of two or more operations not under common control combining, where no remaining entity retains control or shared control;

A **combining operation** is an operation that combines with one or more other operations [in an amalgamation] to form the resulting entity;

Shared control exists where an entity has voting rights, contractual arrangements or ownership interests that allow it to participate in decisions regarding another entity.

Comparison with existing amalgamation definition

63. The CP 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.

An amalgamation is a public sector combination (...)

64. For simplification reasons, staff replaced “is a transaction or other event where (a) two or more operations combine” by “public sector combination” because amalgamations are only to include “the bringing together of separate operations into one entity” which is the definition of public sector combination.
65. At the same time, the amalgamation definition excludes the transfer of assets and liabilities that are not related to operations. Staff notes that this exclusion is consistent with the CP (see paragraph 2.44 of the CP).

(...) not under common control (...)

66. Staff added the words “not under common control” following the IPSASB decision in September 2014 that combinations UCC would be by default reorganizations and by exception acquisitions. This leads to the fact that amalgamations will only occur in a NUCC context.

(...) (a) two or more operations within the public sector combine to form a new entity, (...)

67. At the September 2014 meeting, staff presented a case where three entities (two public sector entities NUCC and a private sector entity) combined operations to form a new entity, each original entity owning one third of the new entity. As no entity gained control, this could be seen as meeting the CP definition of an amalgamation.
68. There can also exist the case where through Parliament law operations from a private sector entity can be combined with operations from municipalities to create a new regional body under public ownership, but without ownership interests linked to the combined entities. This case would also be considered an amalgamation according to the current definition (none of the combining operations gain control of the other operations).
69. However, for the reasons stated in paragraph 17, a combination of operations that affect different sectors can never be an amalgamation. By including the words “occurs only within public sector” in the amalgamation definition, it addresses the fact that amalgamations can only occur within the public

sector where the nature of ownership and control of the resources by public sector entities leads “to deliver services to the public, rather than to make profits and generate a return on equity to investors”.

70. The new entity may be a new legal entity, but this is not a requirement. Substance over form should be applied to classify the new entity. This means that one of the existing entities can be used to receive the operations but, in substance, must be a different entity after the combination. For example, the entity has a new governing body. Staff is of the view that further guidance is necessary to classify the resulting entity as a new entity.

(...) (b) no consideration is transferred, (...)

71. It follows from the IPSASB’s decision at its September 2014 meeting that, for a PSC to be classified as an amalgamation, there cannot be any exchange (see the earlier discussion at paragraph 21). Through the existence of consideration, it is possible to identify an exchange and, therefore, an acquirer. This provides conclusive proof of an acquisition.

(...) and (c) no remaining entity retains control or shared control over the resulting entity, (...)

72. The words “no remaining entity retains control or shared control over the resulting entity” replace the words “none of the combining operations gain control of the other operations” to address the apparent conflict in a combination where no remaining entity gained control but kept a shared control or any ownership link over the resources would still meet the definition of an amalgamation.
73. In an amalgamation, the resulting public sector entity gains ownership and control of the operations but has no relationship with the remaining entities. In other words, in an amalgamation the resulting entity is a new stand-alone entity without any ownership or control link to the remaining entities.
74. If one of the remaining entities retained any control link to the new entity, then it could be possible to identify it as an acquirer and, therefore, the combination would be considered as an acquisition. The fact that in an amalgamation it is not possible to identify an acquirer, makes it a distinct PSC from an acquisition. It is also different from joint ventures because, in a joint venture, there is joint control from the combining entities.
75. In order for an acquisition to exist, it is always necessary to identify an acquirer [recipient]. In an acquisition the acquirer [recipient] that gains control of operations participates in the combination. In an amalgamation, the resulting entity is not a participant to the combination as it only appears as a result of the combination.
76. In an acquisition, the acquirer often leads the process of combination. In an amalgamation, the resulting entity did not participate in the process of combination.
77. In an acquisition, the acquirer often appoints the majority of the governing body of the newly formed entity and/or maintains its statutes, operational and financial policies from one of the remaining entities. In an amalgamation, the governing body and/or its statutes, operational and financial policies are new.
78. Sometimes one of the existing entities can be used as the legal basis to receive the operations from the other entity. If this is the case then, that entity must not have the governing body and/or other elements that can identify it as an acquirer. The resulting entity, whether a new legal entity or one of the existing entities being used as the legal resulting entity, must be always be a new economic entity.

79. In an amalgamation, the assets and/or liabilities related to operations are put together in a new entity without a transfer of consideration to the combining entities or any of their owners. In an acquisition, one of the parties receives or has a right to receive compensation for the assets that it surrenders, if their value is not nil.
80. Staff also proposes the following definitions in the context of amalgamations:
- A **remaining entity** is an entity that loses control of one or more of its operations to the resulting entity in an amalgamation, without gaining any shared control over that entity;
- Shared control** exists where an entity has voting rights, contractual arrangements or ownership interests that allow it to participate in decisions regarding another entity.
81. Staff proposes the “remaining entity” definition to identify the party that loses control of one or more of its operations to the resulting entity without gaining any shared control over that entity. This definition is applied to amalgamations where only operations that belong to entities are combined and a new entity is created.
82. Staff proposes the term “shared control” to reflect that the combining entity has no relationship with the resulting entity after the combination takes place. Staff also sees “ownership interest” as a possible term to be used in the definition.
83. Because of the above proposals, staff proposes changes in the following definitions:
- A **resulting entity** is the new entity that is the result of two or more operations not under common control combining, where no remaining entity retains control or shared control;
- A **combining operation** is an operation that combines with one or more other operations [in an amalgamation] to form the resulting entity.

Alternative Approach

84. Staff considers that the above definitions achieve the IPSASB’s intended outcome regarding the classification of amalgamations. However, staff accepts that it may be possible to achieve this outcome through different wording.
85. This alternative approach seeks to achieve this outcome without the use of the term “shared control”. It is possible that the IPSASB may consider that this idea is in conflict with the current definition (in other IPSASs) of “control”, where an entity either has control of another entity, or does not have control.
86. As discussed earlier, an amalgamation cannot occur where there is an exchange. Staff considers that, where a remaining entity gains an interest (whether through control, contractual arrangements or ownership) in the new entity, an exchange has taken place. The remaining entity has exchanged its operation in exchange for an interest in the new entity. As a result, it will be possible to identify consideration (and hence an acquirer). The combination will, therefore, be classified as an acquisition.
87. Guidance could be included in a future IPSAS to clarify that an amalgamation does not occur when any of the remaining entities has an interest in the new entity. Only where no remaining entity has an interest in the new entity could the combination be classified as an amalgamation.

88. Allowing for this guidance, it would be possible to amend the definitions as follows:
- (a) An **amalgamation** is a public sector combination not under common control where (a) two or more operations within the public sector combine to form a new entity, and (b) no consideration is transferred;
 - (b) A **remaining entity** is an entity that loses control and ownership rights in one or more of its operations to the resulting entity in an amalgamation;
 - (c) A **resulting entity** is the new entity that is the result of two or more operations not under common control combining; and
 - (d) A **combining operation** is an operation that combines with one or more other operations [in an amalgamation] to form the resulting entity;
89. The definition of **shared control** is not required in this alternative approach. Staff considers that the requirement in the original definition of an amalgamation that “none of the combining operations gain control of the other operations” is no longer required. This will be addressed in the discussion of whether the combination gives rise, in substance, to a new entity.

Matter(s) for Consideration

3. The IPSASB is asked to **indicate** whether it agrees with staff's proposals that:
- (a) An **amalgamation** is a public sector combination not under common control where (a) two or more operations within the public sector combine to form a new entity, (b) no consideration is transferred, and (c) no remaining entity retains control or shared control over the resulting entity;
 - (b) A **remaining entity** is an entity that loses control of one or more of its operations to the resulting entity in an amalgamation, without gaining any shared control over that entity;
 - (c) A **resulting entity** is the new entity that is the result of two or more operations not under common control combining, where no remaining entity retains control or shared control;
 - (d) A **combining operation** is an operation that combines with one or more other operations [in an amalgamation] to form the resulting entity;
 - (e) **Shared control** exists where an entity has voting rights, contractual arrangements or ownership interests that allow it to participate in decisions regarding another entity; or
 - (f) Whether the IPSASB supports the definitions in the alternative approach or any other variation in the definitions.

Acquisitions

Nature of acquisitions

90. As seen in paragraph 37, in order to have acquisitions there must exist two essential features:
- (a) One party gaining control over resources; and
 - (b) The parties to the transaction act independently.
91. This has led staff to discuss about the nature of a PSC by acquisition to be distinguished from other combinations using other factors to supplement the current definition of an acquisition.

92. The change of ownership, change of control and the reporting entity level will also be discussed as requested by IPSASB at the September 2014 meeting.
93. Going beyond the reporting entity to classify PSC was already acknowledged by IPSASB in the CP and in the September 2014 meeting when it recognized that combinations that occur under the same economic entity (UCC) can have a different nature from combinations that occur between different economic entities (NUCC), although in both cases there will be always one entity gaining control of one or more operations. PSC UCC are now called by default reorganizations, although acquisitions can also occur.
94. The same happens with amalgamations (a PSC NUCC) where there is one entity (the resulting entity) gaining control of one or more operations, but no remaining entities retain control or shared control over the resulting entity.
95. In these cases, the application of the acquisition definition (i.e. a recipient gaining control) could not be restricted to the reporting entity, but it should also attend the perspectives of the counterparty that is involved in the combination for assessing the features of the combination. If one restricts the classification of PSC to the entity that receives and gains controls of the operations (the recipient), then only acquisitions would exist.
96. Staff is of the view that identifying several types of acquisitions provides guidance in distinguishing it from the other types of PSCs.
97. In paragraphs 24-34 staff already identified several types of acquisitions:
- (a) Market acquisition, exchange transaction, commercial transaction of entities/operations;
 - (b) Bargain purchases where there is (no) nominal consideration of entities/operations;
 - (c) Donations of entities/operations from private sector entities or individuals to public sector entities;
 - (d) Uncompensated seizure of assets with operations (i.e. a forced nationalization).
98. The common thread in all these combinations is that the willing party (the acquirer) that exists prior to the combination remains after the combination.
99. Staff is of the view that the examples presented above can serve as a basis for guidance in the future Exposure Draft.
100. Staff proposes the following definitions:
- An **acquisition**, for the purposes of this Standard, is a public sector combination between parties acting independently that results in an entity other than a resulting entity gaining control of one or more operations;
- A **recipient** is the entity that gains control of one or more operations in an acquisition;
- A **transferor** is the entity that loses control of one or more of its operations to the recipient in an acquisition;
- An **acquired operation** is an operation of which a recipient gains control in an acquisition;

101. The CP definitions were:

An **acquisition** is a transaction or other event that results in a recipient gaining control of one or more operations

A **recipient** is the entity that gains control of one or more operations in an acquisition.

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

102. In the acquisition definition, staff proposes to add:

(...) for the purposes of this Standard (...)

103. Staff proposes to incorporate these words into the definition of an acquisition as the Conceptual Framework and other IPSASs (for example IPSAS 17) use the terms acquired and acquisition in their broader usage.

(...) is a public sector combination (...)

104. Related to the prior change, staff replaced “is a transaction or other event” because an acquisition will always be considered in the context of a public sector combination.

(...) between parties acting independently (...)

105. This change reflects the distinction that must be made with reorganizations.

106. Staff proposes to add the definition of acquired operation because it enabled to identify the part that is acquired in the combination.

107. In the transferor definition, staff replaced “another entity (the recipient)” with “the recipient” for simplification reasons and to be consistent with other definitions.

108. Staff proposes no change to the recipient definition. However, in the terminology section it is discussed the possibility to change the term recipient with acquirer.

Matter(s) for Consideration

4. The IPSASB is asked **to indicate** whether it agrees with staff’s proposals that:
 - (a) An **acquisition**, for the purposes of this Standard, is a public sector combination between parties acting independently that results in an entity other than a resulting entity gaining control of one or more operations;
 - (b) A **recipient** is the entity that gains control of one or more operations in an acquisition;
 - (c) A **transferor** is the entity that loses control of one or more of its operations to the recipient in an acquisition;
 - (d) An **acquired operation** is an operation of which a recipient gains control in an acquisition.

Accounting Treatments

109. This section of the Issues Paper describes the accounting treatments identified in the CP as options for accounting for public sector combinations, and discusses any general issues where an IPSASB decision may be required. The Issues Paper then considers which accounting treatment is most appropriate for each type of combination identified earlier in this Issues Paper.

Acquisition Method

110. The CP provided a description of the acquisition accounting method of accounting based on its application in IFRS 3. Staff considers it appropriate for the acquisition method in any future IPSAS to be based on IFRS 3, as related IPSASs are based on their IFRS equivalents (for example, the standards on interests in other entities which are considered elsewhere on the agenda). Basing the acquisition method of accounting on the requirements of IFRS 3 will help to ensure consistent operation of the standards.
111. Under the acquisition method of accounting, one entity (the acquirer) obtains control of an operation (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 (for example, internally generated intangible assets).
112. Goodwill is measured indirectly as the excess of the aggregate of consideration transferred and the amount of non-controlling interests (if any), over 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

113. The acquisition method of accounting recognizes items arising from a combination that meet the definitions of elements and are able to be reliably measured, as at the acquisition date. This is the date on which the acquirer gains control of the acquiree.
114. The CP included two preliminary views regarding recognition:
- PV 4 stated 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."
- PV 6 stated that an "acquisition UCC should be recognized in the financial statements of the recipient on the date the recipient gains control of the acquired operation."
115. Eight respondents (5, 10, 14, 18, 20, 22, 23 and 24) support PV 4. Nine respondents (5, 10, 11, 14, 18, 20, 22, 23 and 24) support PV 6. No respondents disagree with either PV. Respondent 10 suggests additional guidance be provided on determining the acquisition date.
116. Staff proposes that an acquisition should be recognized in the financial statements of the recipient on the date the recipient gains control of the acquired operation, in line with IFRS 3 and the proposals in the CP.

Measurement

117. Although the acquisition method of accounting is based on fair value, the CP did not reach a conclusion on the measurement basis to be applied to acquisitions NUCC. SMC 4 asked the following question:
- "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);
- (b) Distinguishing between different types of acquisitions (Approach B) so that:
 - (i) For acquisitions where no or nominal consideration is transferred, the carrying amounts of the assets and liabilities in the acquired operation's financial statements are recognized, with amounts adjusted to align the operation's accounting policies to those of the recipient, at the date of acquisition; and
 - (ii) For acquisitions where consideration is transferred, fair value measurement is applied to the identifiable assets acquired and liabilities assumed in the operation, at the date of acquisition; or
- (c) Another approach?

Please explain why you support Approach A, Approach B or another approach."

- 118. Eleven respondents (1, 12, 14, 15, 17, 18, 20, 21, 22, 24 and 25) support Approach B. Five respondents (5, 6, 10, 19 and 26) support Approach A and a further five (7, 8, 11, 16 and 23) support Approach A but define acquisitions differently to the CP. These respondents would align the choice of measurement basis with the classification of the combination.
- 119. Those who support Approach B consider that fair value measurement is only appropriate where there is consideration as this provides a new cost basis for the assets and liabilities acquired. Without this new cost basis, they do not consider that fair value measurement provides better information. These respondents consider acquisition accounting should only be used for combinations with "commercial substance" or a similar term.
- 120. Those who support Approach A consider consistency with IFRS 3 and other IPSASs to be important. Allowing different measurement bases may create opportunities for structuring.
- 121. For acquisitions UCC, the IPSASB proposed (in PV 7) measuring the combination at carrying amount. This is consistent with Approach B (i).

"The recipient in an acquisition UCC recognizes in its financial statements on the date of acquisition the carrying amounts of the assets and liabilities in the acquired operation's financial statements, with amounts adjusted to align the operation's accounting policies to those of the recipient."
- 122. Paragraph 5.2 of the CP notes that the CP "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."
- 123. Staff considers that the CP's measurement proposals for some combinations regarded as acquisitions by the CP apply the modified pooling of interests method described later in this Issues Paper (although the CP did not refer to the approach in these terms). The IPSASB has already agreed to limit the scope of acquisitions, and staff considers these proposals no longer apply.
- 124. These approaches are intended to reflect the fact that in the public sector, some acquisitions (as defined in the CP) lack commercial substance. Respondents who support Approach B consider that the acquisition method of accounting is not appropriate in such circumstances. In this Issues Paper, these issues have been addressed in the classification discussions. This Issues Paper proposes a

revised definition of an acquisition, and additional guidance for distinguishing between an acquisition and an amalgamation. Staff considers that the effect of these proposals would be to limit acquisitions to those that had commercial substance, particularly those that involve an exchange of consideration. This addresses the concerns of those who support Approach B.

125. Staff notes that the IPSASB has already decided that an acquisition can occur without consideration, for example where an operation is donated to a public sector entity. The IPSASB has agreed that this should be recognized at fair value, in line with other non-exchange transactions. Staff has therefore concluded that the acquisition method of accounting should not include carrying amount as a measurement approach.
126. The acquisition method of accounting will therefore use the concept of fair value as its measurement basis. The IPSASB defines fair value in IPSAS 9, paragraph 11 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.”
127. 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.
128. The definition of fair value in IPSAS 9 mirrors the definition used in IFRSs at the time IPSAS 9 was issued. Since then, the IASB 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, Appendix A). This definition is explicitly an exit value, unlike the definition in IPSAS 9.
129. The Conceptual Framework does not define fair value. In the Basis for Conclusions (paragraph BC7.28), the IPSASB explains its rationale for this decision:

“On balance, the IPSASB concluded that, rather than include an exit value-based definition of fair value, or a public sector specific definition of fair value, the Conceptual Framework should include market value as a measurement basis rather than fair value. The IPSASB sees fair value as a model to represent a specific measurement outcome. The IPSASB may carry out further work at standards level to explain how the measurement bases in this chapter align with fair value, as implemented in IFRS.”
130. Elsewhere on this agenda the IPSASB will approve its Work Plan. One project being considered for the Work Plan is a project on measurement. If approved, this project would consider whether the references to ‘fair value’ in existing IPSASs should be retained if it is defined as an exit value as in IFRS 13.
131. In the absence of an IPSAS on measurement, staff considers that inconsistencies between the application of the acquisition method under IFRS and the application of the acquisition method under IPSAS are inevitable. The CP notes this possibility, but did not seek respondents’ views on the use of fair value as the Conceptual Framework was under development and at that time it was uncertain whether fair value would be included as a measurement basis.
132. The following paragraphs describe the measurement options identified by staff for the acquisition method in a future IPSAS.

Retain fair value in a future IPSAS

- 133. A future IPSAS could require assets and liabilities measured using the acquisition method to be measured at fair value. This would maintain consistency with the wording of IFRS 3.
- 134. The different definitions of fair value in IFRS and IPSAS may lead to inconsistent measurement when the standards are applied by preparers. Alternatively, preparers may elect to apply the fair value guidance in IFRS 13 when interpreting the definition of fair value in a future IPSAS. This would minimize differences with acquisitions measured under IFRS, but may not be fully consistent with the IPSASB's Conceptual Framework.
- 135. Preparers may interpret fair value in different ways. This may have the effect of reducing comparability between the financial statements of different entities.

Refer to market value or current value in a future IPSAS

- 136. A future IPSAS could require assets and liabilities measured using the acquisition method to be measured at market value rather than fair value. This would be consistent with the approach taken in the Conceptual Framework. However, specialized assets may be held to deliver services, and the value of services provided may exceed the value receivable from a sale. The Conceptual Framework notes (paragraph BC7.25) that it is questionable whether exit value-based measures would provide relevant information for many assets held for their operational capacity and for liabilities where it is not feasible to transfer the liability.
- 137. The use of market value may not be appropriate in such circumstances. Staff notes that the fair value approach as set out in IFRS 13 makes use of valuation techniques that may include entry values where market values are not available. Replacing the requirement to measure assets and liabilities at fair value with a requirement to measure them at market value would remove this possibility.
- 138. Including a requirement to measure assets and liabilities at market value would also introduce an inconsistency in wording between IFRS 3 and a future IPSAS.
- 139. Alternatively, a future IPSAS could require assets and liabilities measured using the acquisition method to be measured at current value rather than fair value.
- 140. The consequences of such a requirement would be similar to those arising from requiring assets and liabilities to be measured at market value. However, using the term current value would allow measurement bases other than market value to be used when this was appropriate.
- 141. The disadvantage of requiring assets and liabilities to be measured at current value is that, in the absence of specific guidance, it would require preparers to consider which of the current value measurement bases in the Conceptual Framework was most appropriate for each asset and liability. This may be onerous for preparers, and may not meet the QC of comparability.

Provide specific measurement guidance in a future IPSAS

- 142. A future IPSAS on public sector combinations could provide specific guidance on the measurement of the assets and liabilities involved in an acquisition. This guidance would set out when it is appropriate to use market value, and when other measurement bases should be used.
- 143. In providing such guidance, a future IPSAS on public sector combinations would be including guidance equivalent to that provided by IFRS 13, tailored to acquisitions. This would introduce an

inconsistency in the wording between IFRS 3 and a future IPSAS, but may produce the most comparable financial statements.

144. Developing such guidance is likely to consume significant staff and Board time, and may duplicate work undertaken on a possible measurement standard. There is also a risk that preparers would apply the guidance to fair value more widely, which may preempt decisions taken on a measurement standard.

Staff proposal

145. On balance, staff proposes retaining the term fair value in a future IPSAS on public sector combinations. The term is widely used in IPSAS literature, and its use would maintain consistency with the wording of IFRS 3. Inconsistencies in the application of fair value between IPSAS and IFRS could be addressed in a future measurement standard, if approved. The IPSASB may wish to make any decision on this issue conditional on the approval of the Work Plan.

Treatment of the difference - goodwill

146. Under IFRS 3, an acquirer recognizes goodwill where (assuming no non-controlling interests) the consideration transferred exceeds the fair value of the acquiree's net identifiable assets and liabilities.
147. The CP doubts whether goodwill could arise in the public sector unless an acquirer acquires a cash-generating operation. As the IPSASB's Conceptual Framework was incomplete at the time the CP was issued, this view is based on the IASB's *Conceptual Framework for Financial Reporting*. This explains that the future economic benefits embodied in an asset relate to "the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the entity."
148. The CP suggests that goodwill as defined by in IFRS will only arise in the public sector where an acquirer acquires a cash-generating operation. The CP (in paragraph 5.39) also suggests that, alternatively, the IPSASB could develop a definition of goodwill (or a similar term) that encompasses the concept of service potential.
149. The CP (in Specific Matter for Comment 5) seeks respondents' views on whether goodwill should be recognized in the public sector in an acquisition NUCC where fair value is used as the measurement basis:

"In your view, where the consideration 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)."

150. Four respondents (9, 11, 20 and 25) support option (a). Two respondents (7 and 23) prefer option (b) conceptually, but support option (a) for practicality reasons. One further respondent (18) supports a

different approach whereby goodwill is recognized only where an acquired operation is not in the public sector. This approach is most similar to option (a). Seven respondents (5, 6, 19, 21, 22, 24 and 26) support option (b). One further (16) respondent supports option (b) on the assumption goodwill would be amortized on a systematic basis. Seven respondents (1, 4, 10, 12, 13, 15 and 17) support option (c). Respondent 8 generally supports option (c), but notes that a minority of their members would support option (b) if the IPSASB develops a concept of goodwill that encompasses service potential.

151. This results in seven respondents supporting option (a), eight respondents supporting option (b) and eight respondents supporting option (c). This suggests that a majority of respondents consider that goodwill can meet the definition of an asset, at least in some circumstances.
152. The CP also seeks respondents' views regarding the treatment of the difference in acquisitions UCC. As the CP in effect proposes the modified pooling of interests method for acquisitions UCC, goodwill is not one of the options presented. Following the IPSASB's decision at the September 2014 meeting that almost all combinations UCC should be classed as reorganizations, and that acquisitions UCC will only arise exceptionally, staff considers that all acquisitions should be accounted for in the same manner. If goodwill can arise in an acquisition NUCC, there is no reason why it cannot arise in the limited circumstances in which an acquisition UCC will arise. An acquisition UCC will only occur when the combination takes place as if it was NUCC.
153. The completion of the IPSASB's conceptual framework at the September 2014 meeting changes the basis for discussing goodwill. This discussion now needs to consider the Conceptual Framework's definition of an asset. Paragraph 5.6 of the Conceptual Framework describes an asset as a "resource presently controlled by the entity as a result of a past event."
154. In this context, control refers to the control of an asset. This is defined in IPSAS 23 paragraph 7 as arising when the entity can use or otherwise benefit from the asset in pursuit of its objectives, and can exclude or otherwise regulate the access of others to that benefit. Staff considers that goodwill satisfies this definition, albeit that the benefits can only be accessed in conjunction with other assets.
155. Paragraph 5.7 describes a resource as "an item with service potential or the ability to generate economic benefits." Paragraph 5.10 notes that economic benefits "are cash inflows or a reduction in cash outflows." Consequently, the definition of an asset incorporates economic benefits arising from the ability of a resource to reduce cash outflows as well as to generate additional cash inflows.
156. The following paragraphs discuss the circumstances in which goodwill in a public sector combination might meet the revised asset definitions included in the Conceptual Framework.

Acquisitions of cash-generating operations

157. The CP considers that goodwill could meet the definition of an asset where an acquirer acquires a cash-generating operation. In these circumstances, goodwill represents a resource that provides the entity with economic benefits in the form of future cash inflows. The entity is able to access these economic benefits as the operation generates the cash flows over time. This assessment does not change in the light of the extension of the asset definition to include reductions in cash flows.
158. Goodwill cannot be identified separately from the assets and liabilities acquired. As the acquirer controls these assets and liabilities, it follows that the acquirer controls any goodwill that arises, as the goodwill can only be accessed through those other assets and liabilities.

159. As noted above, seven respondents support including goodwill for cash-generating operations, with a further eight respondents supporting an extension of goodwill to incorporate service potential. Staff considers these respondents (a clear majority of those who commented on SMC 5) consider that goodwill meets the definition of an asset for cash-generating operation.
160. Staff proposes that a future IPSAS should require the recognition of goodwill where an acquisition relates to cash-generating operations, as proposed in the CP.

Acquisitions of operations that deliver reductions in cash outflows

161. Paragraphs 5.40 and 5.41 of the CP note that:

“Some believe that the excess of consideration transferred over the acquisition date amounts of the fair value of the acquired operation’s net identifiable assets and liabilities does meet the definition of an asset because the future service potential is represented by the prospect that the acquired operation’s existing activities are more efficient or effective than acquiring the equivalent net assets separately. Those of this view consider that (a) goodwill exists 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.

Others argue that the excess of consideration transferred over the acquisition date amounts of the fair value of the acquired operation’s net identifiable assets and liabilities 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.”

162. As set out in the views above, those who consider that goodwill can arise in service delivery operations base their arguments on the premise that acquiring an operation gives rise will result in the more efficient or effective delivery of services. Those who consider goodwill does not arise base their arguments on the premise that service potential is can only be linked to individual assets.
163. The Conceptual Framework describes economic benefits as cash inflows or a reduction in cash outflows. The acquisition of an operation that results in the more efficient or effective delivery of services may result in the net cash outflows of the acquirer being reduced. In such circumstances, staff considers that this reduction meets the Conceptual Framework definition of an asset and so should be accounted for as goodwill. The definitions of a resource and of an asset have effectively been widened by including “a reduction in cash outflow” in the description of economic benefits.

Acquisitions of operations that result in service potential but no reductions in cash outflows

164. The Conceptual Framework acknowledges that a resource can provide service potential, economic benefits or both. This gives rise to the possibility that an acquisition could give rise to a resource with service potential but no economic benefits (i.e., no cash inflows or reduction in cash outflows).
165. Staff considers that where an acquisition will generate service potential without any resulting positive change in the cash flows associated with the operation, any consideration transferred in excess of the fair value of the net assets does not give rise to an asset. Staff is persuaded by the argument in

IPSAS 21 that it is possible to identify the service potential of individual assets, and hence service potential does not arise independently of those assets.

166. Even if this were not the case, staff considers that an entity would not be able to access the service potential that arose independently of individual assets, and that such service potential could not be reliably measured.

Staff proposal

167. Staff proposes that consideration transferred in excess of the fair value of net assets acquired should be recognized as goodwill where the acquisition will result in:

- (a) The generation of cash inflows (such as the acquisition of a cash-generating operation); or
- (b) A reduction in the net cash outflows of the acquirer.

168. In other circumstances, the excess should not be recognized as goodwill.

Matter(s) for Consideration

5. The IPSASB is asked **to indicate** whether it supports the staff proposals that:
- (a) The term 'fair value' is retained as the measurement basis for acquisitions in a future IPSAS on public sector combinations; and
 - (b) That goodwill is recognized in an acquisition where the acquisition will result in:
 - (i) The generation of net cash inflows of the acquirer; or
 - (ii) A reduction in the net cash outflows of the acquirer.

Pooling of Interests Method and Modified Pooling of Interests Method

169. The pooling of interests method of accounting is intended for application to a business combination in which an acquirer cannot be identified. The CP describes the pooling of interests method as prescribed in IAS 22. The pooling of interests method of accounting is also known as the uniting of interests' method of accounting or merger accounting.
170. 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.

Recognition

171. IAS 22 required that the pooling of interests method would recognize a uniting of interests by accounting for the combining 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 entity 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).

Modification to the point of recognition proposed in the CP

172. The CP noted that some are of the view that the pooling of interests method could be modified to require the combined 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.
173. 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, the CP refers to it as the “modified pooling of interests” method.

Measurement

174. The pooling of interests method and modified pooling of interests method use the carrying amounts of items recognized in the financial statements of the combining entities, with amounts adjusted to align the accounting policies of the combining entities to those of the combined entity, 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 the CP refers to it as a “measurement approach.”

Treatment of the difference

175. The descriptions of the pooling of interests method and the modified pooling of interests method in the CP make the assumption that the only differences that arise result from the restating of accounting policies (see paragraph 170). This is consistent with the approach taken in IAS 22.
176. However, there are two circumstances in which a further difference may arise, as the CP considers combinations not addressed in IAS 22

Combinations UCC

177. Table 2 of the CP notes that under the pooling of interests and modified pooling of interests methods, the only type of consideration that arises is an exchange of shares. This is consistent with these methods being applied to a merger of equals; shares in the predecessor entities are exchanged for shares in the new entity, and not further consideration is required.
178. Where a combination UCC takes place, the controlling entity may require consideration to be transferred. This is consistent with the view that in a combination UCC, the controlling entity is merely rearranging their assets and liabilities. As part of the combination, it is within their power to transfer consideration. This may occur where a controlled entity has been permitted to build up reserves to manage risks. If these risks are reduced or eliminated as a result of the combination, the controlling entity may appropriate some or all of the reserve.
179. Alternatively, the controlling entity may provide additional resources as part of a combination.
180. Should either the pooling or modified pooling of interests methods be applied to some or all combinations UCC, it will be necessary to account for any consideration transferred or any contribution received.

181. Although the CP does not directly address the treatment of a difference under the pooling of interests method or the modified pooling of interests method, it does so indirectly. The CP in effect proposes the use of the modified pooling of interests method for acquisitions UCC. In this context, SMC 6 asks:

“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 then the gain or loss meets the definition of a contribution from owners or distribution to owners?

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

182. Of the three options set out in the CP, a contribution from owners or distribution to owners (option (b)) received most support (Respondents 1, 6, 7, 8, 15, 17, 19, 23 (if acquisitions NUCC is retained), 24 and 26). These respondents identify support for this approach in IPSAS 1.
183. A gain or loss recognized in surplus or deficit (option (a)) received the next highest level of support (Respondents 4, 5, 9, 18 and 20). These respondents identify support for this approach in IPSAS 6.
184. Three respondents (21, 22 and 25) support option (c), and respondent 10 supports a modified version of option (c). Four respondents (3, 11, 12 and 16) make other comments on this SMC. Other respondents either did not comment on this SMC or did not indicate a preference.
185. Staff considers that, in a combination UCC, any consideration transferred would meet the definition of an ownership distribution. Any additional resources provided by the controlling entity would similarly meet the definition of an ownership contribution. Staff therefore proposes that any difference arising in a combination UCC under either the pooling of interests method or the modified pooling of interests method be treated as a transaction with owners.

Combination of Operations

186. The description of the pooling of interests method in IAS 22 assumes that the combination involves two or more entities. Where an entity is involved in a combination, the difference between the carrying amounts of that entity's assets and liabilities is reflected in its equity. Where an operation is involved in a combination, there may be no explicit transfer of equity, and the accounting treatment of any difference between the carrying amount of the transferred operation's assets and liabilities will need to be determined. This issue was not addressed in the CP.
187. Staff proposes that where the operations involved in the combination are UCC, the difference should be treated as an ownership contribution or ownership distribution, for the reasons given in the discussion of combinations UCC above.
188. Where the operations involved in the combination are NUCC, staff proposes that the difference should be recognized in the resulting entity's equity. Staff considers that the difference arises from the combination, not the performance of the resulting entity and so the difference should not be recognized in the statement of financial performance. Staff considers that reporting the difference in

the statement of financial performance would misstate the cost of services of the resulting entity and thus fail to meet the measurement objective in the Conceptual Framework.

Predecessor Accounting Method

189. The manuals of accounting issued by various firms identify predecessor accounting as an appropriate accounting policy for combinations UCC. Predecessor accounting is similar to the modified pooling of interests method proposed in the CP, but also requires any differences arising (specifically in respect of consideration transferred) to be recognized in equity.
190. Predecessor accounting also requires assets and liabilities to be recognized at the amounts recorded in the ultimate controlling entity's consolidated accounts. These amounts may be different than the carrying amounts in the controlled entity's accounts. An example would be where the controlled entity had previously been acquired from another entity (not under common control). In an acquisition, the controlling entity's accounts would reflect the fair value of the acquired entity's assets and liabilities on acquisition. However, the acquisition would not change the carrying amounts in the controlled entity's accounts. 'Push down' accounting (whereby the controlled entity's financial statements are restated to reflect the revised measurement in the acquirer's financial statements) is not required under IPSAS.
191. Staff considers recognizing assets and liabilities at the amounts recorded in the ultimate controlling entity's consolidated accounts to be appropriate. Those who argue that the pooling of interests or modified pooling of interests methods are appropriate for combinations UCC take the view that the controlling entity is merely rearranging their assets and liabilities. In such circumstances, it is appropriate that the combination reflects the measurement of those assets and liabilities by that controlling entity.

Matter(s) for Consideration

6. The IPSASB is asked **to indicate** whether it supports the staff proposals that:
- (a) That any difference arising under the pooling of interests and modified pooling of interests methods is recognized:
 - (i) For combinations UCC, as an ownership distribution or ownership contribution; and
 - (ii) For combinations NUCC, in equity.
 - (b) When the pooling of interests or modified pooling of interests methods are applied to combinations UCC, the measurement basis should be the carrying amount of the assets and liabilities in the ultimate controlling entity's financial statements.

Fresh Start Method

192. 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 entities. 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.

193. Staff notes that under the fresh start method, any difference between the fair value of the assets and liabilities of the resulting entity, and any consideration transferred, is reflected in equity. Staff considers this is appropriate for the reasons set out under pooling of interests section above.
194. Staff notes that the fresh start method refers to fair value. Staff considers that the decision reached by the IPSASB regarding the use of the term 'fair value' for acquisitions should be applied equally to the fresh start method should this method be included in a future IPSAS on public sector combinations.
195. The CP does not propose the use of the fresh start method, and hence does not seek respondent's views on any aspects of the method. Only one respondent to the CP proposed the use of the fresh start method. Staff therefore does not consider it necessary to reopen the question as to whether the fresh start method should be used. The discussion of the fresh start method as a possible accounting treatment for the different types of combination in the following paragraphs is intended to provide the basis for conclusions for this view.

Selection of Accounting Methods

196. This Issues Paper has described the different accounting methods identified in the CP, and sought the IPSASB's views on a number of generic issues relating to those methods. The following paragraphs consider which methods may be most appropriate for each class of combination.
197. For each class of combination, the most appropriate accounting method will be the method that best meets the objective of measurement and the qualitative characteristics (QCs) set out in the Conceptual Framework.
198. Paragraph 7.2 of the Conceptual Framework sets out the objective of measurement as follows:

"To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes."

Reorganizations

199. The CP does not distinguish between amalgamations UCC and NUCC, but proposes (in PV 8) that all amalgamations should apply the modified pooling of interests method of accounting.
200. Ten respondents comment on PV 8. Nine respondents (5, 10, 14, 16, 18, 20, 22, 24 and 26) support the PV. Respondent 23 supports the modified pooling of interests method for amalgamations UCC (now defined as reorganizations), but proposes fresh start accounting for amalgamations NUCC (now defined as amalgamations).
201. Staff considers that two respondents (15 and 19) implicitly disagree with PV 8 for the following reasons:
 - Respondent 15 considers that the methods set out in the CP were appropriate for exchange transactions. The respondent recommends that combinations without an exchange of consideration be analyzed in the context of non-exchange transactions rather than the methods

described in the CP. However, the respondent does not suggest any particular methods that could be used.

- In response to SMC 2, respondent 19 does not support a distinction between acquisitions and amalgamations. The respondent considers that acquisition accounting would be an appropriate basis for a finalized IPSAS.
202. Reorganizations involve a controlling entity rearranging the assets, liabilities and operations they control. As such, a reorganization is unlikely to have economic substance. Instead, it is closer in nature to an entity rearranging its own operating divisions.
203. Where an entity rearranges its own operating divisions, the cost of services will reflect activities that take place after the rearrangement. For example, the cost of services may reduce if the new arrangements are more efficient. There is no adjustment to the cost of services in respect of prior activities.
204. This would be the case under the pooling of interests method and the modified pooling of interests method. However, under the acquisitions method or fresh start method, the cost of services could change as a result of the restatement of assets and liabilities to fair value. For example, depreciation based on the fair value of assets could be greater than the depreciation based on the carrying amount of those assets. Applying the acquisition method or fresh start method is unlikely to provide the most appropriate measure of the cost of services for reorganizations.
205. As an exit basis, fair value will provide an appropriate measure of an entity's financial capacity. However, if fair value is derived from a market value, this may not reflect the value to the entity of assets, represented by its operational capacity (see paragraph 7.27 of the Conceptual Framework). To an extent, this may depend on how the IPSASB chooses to address consistency with IFRS regarding fair value.
206. Reorganizations take place UCC and do not have economic substance. Accounting for reorganizations using the acquisition method of accounting is unlikely to faithfully represent the combination as there is no acquisition. As the controlling entity can determine the terms of the combination, any goodwill initially recognized (whether later impaired or not) or any gain or loss recognized on acquisition can be determined by the controlling entity. The goodwill, gain or loss recognized may therefore not faithfully represent the substance of the combination, but only its form.
207. The premise of the fresh start method of accounting is that the resulting entity is a new entity. This will not faithfully represent the nature of many reorganizations, for example where a department under the control of one ministry is transferred to the control of another ministry and the ministries are UCC. As with the acquisition method of accounting, the fresh start method of accounting will provide an appropriate measure of an entity's financial capacity, but is unlikely to provide an appropriate measure of the cost of services or an entity's operational capacity.
208. For these reasons, staff considers that the acquisition method and the fresh start method are not the most appropriate basis for accounting for reorganizations.
209. The CP proposes the modified pooling of interests method rather than the pooling of interests method, as this method recognizes the reorganization on the date it takes place. It is also likely to have lower costs as no restatement of prior periods is required.
210. Respondents to the CP generally support this view, although respondent 23 comments that support for this view is conditional on the financial statements of the combining entities prior to the

amalgamation being publicly available. This respondent considers that users of the financial statements may require information about the entities' performance prior to the combination. Staff supports this assertion, and proposes that information about the combining operations be made available, either in the combining entities' financial statements or in another form.

211. Staff notes that in the UK, both the pooling of interests method and the modified pooling of interests method are required, depending on the circumstances. Where political accountability does not change at the intermediate controlling entity level, the pooling of interests method is used. This occurs, for example, where entities are reorganized within a ministry and the same minister is politically accountable both before and after the reorganization.
212. Where political accountability at the intermediate controlling entity level changes (for example, where an entity is transferred between one ministry and another), the modified pooling of interests method is used.
213. Staff considers this approach has merit, but that it may introduce additional costs and may reduce comparability. Should an entity consider comparative information to be important to its users, this could be provided in a note to the financial statements. Staff therefore does not propose to adopt the UK approach.
214. For the reasons given above, staff proposes that the resulting entity in a reorganization should apply the modified pooling of interests method in accounting for the combination. Any differences arising (for example, where consideration is paid) would be treated as a transaction with owners, in line with the conclusion in paragraph 185. Information about the combining entities would be made available in line with the discussion in paragraph 210.

Matter(s) for Consideration

7. The IPSASB is asked **to indicate** whether it supports the staff proposal to:
 - (a) Require the application of the modified pooling of interests method to all reorganizations;
 - (b) Treat any differences arising as ownership distributions or ownership contributions; and
 - (c) To require information about the combining operations' performance prior to the reorganization to be made available, either in the combining entities' financial statements or elsewhere.

Amalgamations

215. As reported above, the CP proposed that the modified pooling of interests method should be applied to all amalgamations (UCC and NUCC). Respondents generally supported this approach for amalgamations NUCC (now defined as amalgamations), although respondent 23 proposed the fresh start method of accounting for these combinations.
216. As defined in this Issues Paper, no acquirer can be identified in an amalgamation.
217. The consequence of this is that the acquisition method of accounting is not appropriate for amalgamations. The premise of the acquisition method is that an acquirer can be identified. Where this is not the case, the acquisition method will not faithfully represent the combination.
218. Applying the acquisition method to an amalgamation would require the identification of an acquirer where none existed. The assets and liabilities of the operation identified as the nominal acquirer would be presented at carrying amount, with all other assets and liabilities being restated at fair value.

This would not satisfy the QCs of reliability or faithful representation. Staff therefore considers that the acquisition method of accounting is not appropriate for amalgamations.

219. An amalgamation gives rise in substance to a new entity. This entity will have a new governing body. It follows that the entity will not be accountable for activities carried out prior to the amalgamation taking place. The provision of comparative information will not, therefore, provide information that is useful for accountability purposes. For these reasons, staff considers that the pooling of interests method will not be the most appropriate method of accounting for amalgamations.
220. This leave two possible methods of accounting for amalgamations to be considered – the modified pooling of interests method and the fresh start method.
221. Both methods provide useful information regarding the cost of services. In jurisdictions that consider the historical cost perspective most important, the modified pooling of interests method is likely to more closely reflect the historical cost to the public sector of the assets and liabilities involved in the amalgamation. In jurisdictions that consider the current cost perspective most important, the fresh start method is likely to more closely reflect the current value of the assets and liabilities. Staff notes that in these jurisdictions, many entities will already be measuring assets and liabilities at current values, based on the options available in individual IPSASs. Where this is the case, the modified pooling of interests method and the fresh start method are likely to produce similar results, albeit through different means.
222. As discussed when considering the accounting treatment for a reorganization, fair value (as used in the fresh start method) is likely to provide an appropriate measure of financial capacity. However, it may lead to a market value approach that does not reflect the value of assets to an entity, and therefore does not provide an appropriate measure of operational capacity. Carrying amounts (as used in the modified pooling of interests method) are likely to provide an appropriate measure of operating capacity, but may not provide as appropriate a measure of financial capacity if they do not reflect realizable values.
223. The definition of an amalgamation proposed by staff suggests that an amalgamation is a non-exchange transaction, as the definition excludes combinations involving an exchange. IPSASs generally require non-exchange transactions to be measured at fair value. Staff notes that this enables an entity to identify the gain or loss it has experienced. Fair value also acts as a proxy for the cost of assets received.
224. Staff does not consider that this approach means that amalgamations should automatically be measured at fair value (which would imply fresh start accounting). In other IPSASs, there is an existing entity that experiences the gain or loss. In an amalgamation, this is not the case; there is a new entity that is created. An amalgamation is not a transaction that affects the statement of financial performance, and hence it may be appropriate to consider whether different measurement requirements to other non-exchange transactions would be appropriate.
225. A case can be made for adopting either the modified pooling of interests method or the fresh start method. Staff considers that, on balance, operational capacity is likely to be more relevant to more public sector entities than financial capacity, although both are important.
226. The cost benefit constraint may also be important. The requirement to restate all assets and liabilities to fair value will often result in higher costs where the fresh start method is applied.

227. On balance, staff therefore proposes that the resulting entity in an amalgamation should apply the modified pooling of interests method in accounting for the combination. Any differences arising should be recognized in equity rather than the statement of financial position for the reasons given in paragraph 188.

Matter(s) for Consideration

8. The IPSASB is asked **to indicate** whether it supports the staff proposal to:
- (a) Require the application of the modified pooling of interests method to amalgamations; and
 - (b) Recognize any differences arising in equity.

Acquisitions

228. The general principle within IPSAS is that transactions are recognized initially at cost (which in an exchange transaction generally reflects market values), or at fair value in a non-exchange transaction. In an acquisition, one party is gaining control of an operation, either in exchange for consideration or as a result of a non-exchange transaction. An acquisition is most commonly an exchange transaction that has economic substance. Acquisitions can also arise from non-exchange transactions, for example where a not-for-profit organization donates an operation to a public sector entity.
229. In these circumstances, staff considers that measurement at fair value is appropriate. Where consideration has been paid, fair value will be useful for accountability purposes. Users will be able to assess whether the price paid in the acquisition represents good value for money for the assets and liabilities included in the combination, and hold management accountable for the transaction. Where an operation has been donated, fair value best reflects the gain experienced by the recipient.
230. In an acquisition, an existing entity gains control of one or more operation, and in doing so, may experience a gain or a loss. The acquisition method, based on fair value will faithfully represent the extent of this gain or loss. The terms of the acquisition may be determined by a third party, for example a higher level of government. Nevertheless, acquisition accounting will faithfully represent the gain or loss experienced, even if this is different than would have been the case had the acquisition been undertaken without the involvement of the third party. Users will find fair value information useful for accountability purposes; this will be enhanced where any third party involvement is disclosed.
231. Accounting for the acquisition at carrying amount would not provide useful information about the gain or loss, and so would not provide useful information for accountability purposes. Carrying amount would not provide a faithful representation of the acquisition. Staff therefore considers that the pooling of interests method and the modified pooling of interests method would not meet the objective of measurement.
232. Staff also considers that the fresh start method would not be the most appropriate method for an acquisition. The premise of the fresh start method is that a new entity is created, whereas the substance is that an existing entity gains control over one or more operations. Under the fresh start method, all assets and liabilities are revalued. Where one entity acquires an operation, there is no basis to restate the entity's existing assets and liabilities. For these reasons, staff considers that the fresh start method does not provide a faithful representation of an acquisition.

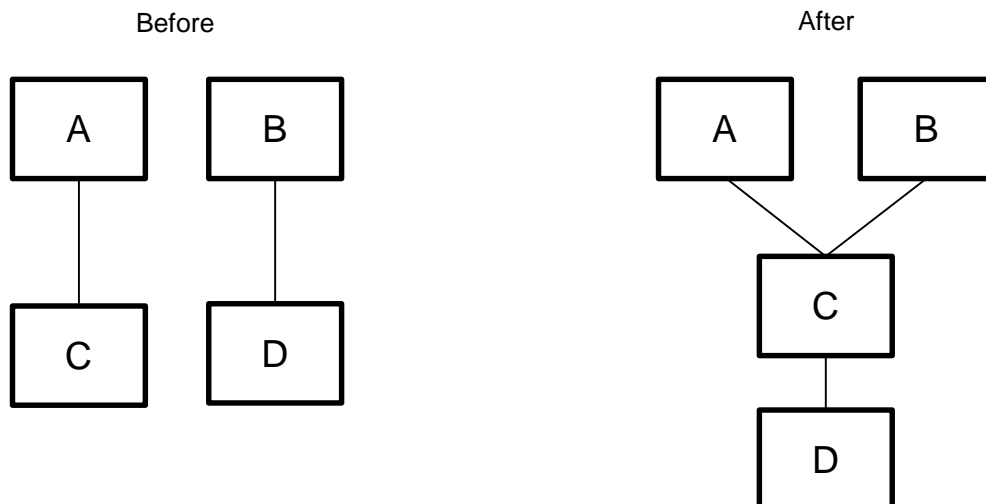
233. Staff therefore proposes that an acquirer should account for the acquisition using the acquisition method of accounting. How fair value should be implemented in a future IPSAS is discussed earlier in this Issues Paper.

Matter(s) for Consideration

9. The IPSASB is asked **to indicate** whether it supports the staff proposal to require an acquirer to account for an acquisition using the acquisition method, based on fair value.

Formation of Joint Ventures

234. Joint ventures are defined in IPSAS XX (ED 51). IPSAS XX (ED 51) specifies the accounting arrangements for joint ventures in the financial statements of a venture. It does not specify the accounting arrangements to be applied in the financial statements of the joint venture itself.
235. The definition of a public sector combination in the CP excluded the formation of a joint venture from the scope of the project. This is consistent with the approach taken in IFRS 3, which also excludes the formation of joint arrangements from the scope of that standard.
236. Under IFRS, where a company contributes assets to a joint venture in exchange for equity in that joint venture, these assets are measured at fair value in accordance with IFRS 2 *Share-based Payment*. IFRS 2 excludes from its scope any contribution that constitutes a business. This means that under IFRS, there is no guidance on how a joint venture should account for its formation where it is formed by the contribution of businesses.
237. Other literature suggests that a joint venture should select an appropriate accounting policy, and measure assets and liabilities contributed as part of a business at either carrying amount or at fair value.
238. This literature suggests that, where an accounting policy of fair value is selected, it is appropriate to apply IFRS 3 by analogy. The literature then proposes that this only applies to a contribution received by a joint venture. Where the joint venture is itself a former subsidiary, it should not restate its own assets to fair value. This is because no contribution has been received, and the change of control of the entity does not trigger the application of fair value. This is best illustrated in the following diagram:



239. In this scenario, entities A and B agree to joint control over entity C (previously a subsidiary of entity A). Entity B contributes entity D to the joint venture, where it becomes a subsidiary of entity C. Applying an accounting policy of measuring assets and liabilities at fair value on the formation of a joint venture, only the assets and liabilities in entity D would be measured at fair value. Effectively, entity C has acquired entity D and applies acquisition accounting. It is less clear how the formation should be accounted for if the joint venture was formed by an amalgamation of entities C and D. Further complications will arise where entities C and D are under common control.
240. Staff considers that this illustrates the complexities that can arise in accounting for the formation of a joint venture. In the public sector, the range of joint ventures that may arise may be wider than in the private sector. Determining the appropriate accounting treatment may require consideration of additional factors to those considered in the rest of this issues paper. Staff therefore proposes that the approach in the CP to exclude the formation of joint ventures from the scope of the project be retained.

Matter(s) for Consideration

10. The IPSASB is asked **to indicate** whether it supports the staff proposal to exclude the formation of a joint venture from the scope of the project.

Terminology

241. At its June 2014 meeting, Members had some sympathy with the views of some respondents who felt that the language in the CP was confusing and did not take account of public sector circumstances.
242. In their responses to the CP, a number of respondents proposed specific changes to the terminology used in the CP.
243. Respondent 25 suggests that the term “acquisition” be replaced with “transfer of operation.” The respondent considers that this term more closely reflects the public sector situation. Staff notes that respondent 15 also suggests that a term other than “acquisition” is used to define combinations not involving the transfer of consideration.
244. Staff considers that it is appropriate to retain the term acquisition. As defined in the CP, acquisitions covered a wider range of transactions than IFRS 3. Staff considers that the amended definitions proposed in this Issues Paper narrows the gap between acquisitions in IFRS 3 and acquisitions in this project. Consequently, it is appropriate for the same term to be used.
245. On a related matter, the CP uses the terms recipient, acquired operation and transferor rather than the IFRS 3 terminology of acquirer, acquiree and former owners. This terminology is intended to reflect the different nature of acquisitions described in the CP. Following the IPSASB’s decisions in previous meetings, acquisitions as defined in this CP are more closely aligned with acquisitions under IFRS 3. Staff consider it would be appropriate for the IPSASB to consider whether it wishes to revert to the terminology applied in IFRS 3.
246. Another term that caused confusion was “amalgamation.” Staff is seeking the IPSASB’s views as to whether this term should be retained or amended.
247. At its September 2014 meeting, the IPSASB decided that combinations UCC should be treated as reorganizations, except where they have the substance of an acquisition. The IPSASB did not

formally agree a term for this class of combination, but referred to the combinations as both reorganizations and restructurings interchangeably.

248. Staff notes that “restructuring” is defined in IPSAS 19 paragraph 18 as:

“A program that is planned and controlled by management, and materially changes either:

- (a) The scope of an entity’s activities; or
- (b) The manner in which those activities are carried out.”

249. For this reason, staff has referred to this class of combination as reorganizations within this Issues Paper. However, other IPSASs also use the word reorganization when describing a restructuring. Staff therefore suggests that an alternative term to be used in a future IPSAS to avoid any confusion. Terms that could be used include “administrative reorganization”², “public sector reorganization” or “government reorganization”. The IPSASB’s views are sought on this matter.

250. The definition of a restructuring in IPSAS 19 could include some combinations. A number of IPSASs have provisions relating to restructurings, and staff considers that consequential amendments may be required in some cases. These relate to:

- (a) The going concern assessment. The CP proposed that in the period between the announcement of an amalgamation and the date of that amalgamation, entities prepare financial statements on a going concern basis where the resulting entity will fulfill the responsibilities of the combining operations.
- (b) Restructuring provisions. It may be necessary to distinguish between restructuring provisions and the cost of a combination.

251. Appendix A includes an initial assessment of where consequential amendments may be required.

252. Respondent 16 suggests that it may preferable to use terminology other than “pooling of interests”. Staff is proposing that the modified pooling of interests method be used for reorganizations and amalgamations. Staff notes that this method is referred to in other literature as the “predecessor accounting method.” Use of this term may provide consistency with other literature and avoid any negative connotations associated with the term “pooling of interests”.

Matter(s) for Consideration

11. The IPSASB is asked **to indicate**:

- (a) Whether it supports the retention of the term “acquisition”;
- (b) Whether to revert to any of the terms used in IFRS 3; this would involve replacing:
 - (i) “recipient” with “acquirer”;
 - (ii) “acquired operations” with “acquiree”; and/or
 - (iii) “transferors” with “former owners”
- (c) Whether the term “amalgamation” should be retained or changed, and if changed, what term should be used;

² Respondents used terms such as administrative arrangements, administrative restructures and administrative reorganizations to describe some combinations. As there are references to administrative arrangements and administrative restructurings elsewhere in the IPSASB’s literature, staff is only suggesting administrative reorganizations as a possible term.

- (d) Which term it prefers to refer to “reorganizations”;
- (e) Whether it supports staff’s proposals for consequential amendments to requirements in other IPSASs relating to “restructurings”; and
- (f) Whether it supports the use of the term “predecessor accounting method” to replace “modified pooling of interests method”.

Presentation

253. This Issues Paper does not discuss detailed disclosure requirements. Instead, it proposes presentation objectives for the project. If the IPSASB supports the presentation objectives, staff will develop the detailed disclosure requirements required to meet the objectives.

254. Staff proposes the following presentation objectives, based on the objectives in IFRS 3:

“An entity shall present information that enables users of its financial statements to evaluate the nature and financial effect of a public sector combination that occurs either:

- (a) During the current reporting period; or
- (b) After the end of the reporting period but before the financial statements are authorized for issue.

An entity shall present information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in current reporting period that relate to public sector combinations that occurred in the period or previous reporting periods.”

255. Staff proposes that the disclosure requirements for acquisitions be based on the wording in IFRS 3. Disclosure requirements for reorganizations and amalgamations would be developed to be consistent with the requirements in IFRS 3, adjusted for the different natures of those combinations.

Matter(s) for Consideration

12. The IPSASB is asked **to indicate** whether it supports:

- (a) The proposed presentation objectives; and
- (b) Staff’s proposed approach to developing disclosure requirements.

Appendix A

Possible consequential changes to restructuring requirements in other IPSASs

IPSAS	Text	Comment
1.41	The determination of whether the going concern assumption is appropriate is primarily relevant for individual entities rather than for a government as a whole. For individual entities, in assessing whether the going concern basis is appropriate, those responsible for the preparation of financial statements may need to consider a wide range of factors relating to (a) current and expected performance, (b) potential and announced restructurings of organizational units, (c) estimates of revenue or the likelihood of continued government funding, and (d) potential sources of replacement financing before it is appropriate to conclude that the going concern assumption is appropriate.	May contradict the approach in the CP that entities should account as going concerns between announcement of amalgamation and implementation.
1.107	Circumstances that would give rise to the separate disclosure of items of revenue and expense include: ... (b) Restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring; ...	No change required as reorganizations would be disclosed separately.
8.13	Joint control may be precluded when a joint venture (a) is in legal reorganization or in bankruptcy, (b) is subject to an administrative restructuring of government arrangements, or (c) operates under severe long-term restrictions on its ability to transfer funds to the venturer. If joint control is continuing, these events are not enough in themselves to justify not accounting for joint ventures in accordance with this Standard.	No change required based on IPSAS 8 requirement; review once new IPSAS issued.
14.17	The determination of whether the going concern assumption is appropriate needs to be considered by each entity. However, the assessment of going concern is likely to be of more relevance for individual entities than for a government as a whole. For example, an individual government agency may not be a going concern because the government of which it forms part has decided to transfer all its activities to another government agency. However, this restructuring has no impact upon the assessment of going concern for the government itself.	May contradict the approach in the CP that entities should account as going concerns between announcement of amalgamation and implementation.

IPSAS	Text	Comment
14.19	In assessing whether the going concern assumption is appropriate for an individual entity, those responsible for the preparation of the financial statements, and/or the governing body, need to consider a wide range of factors. Those factors will include the current and expected performance of the entity, any announced and potential restructuring of organizational units, the likelihood of continued government funding and, if necessary, potential sources of replacement funding.	May contradict the approach in the CP that entities should account as going concerns between announcement of amalgamation and implementation.
14.25	Where a restructuring announced after the reporting date meets the definition of a non-adjustable event, the appropriate disclosures are made in accordance with this Standard. Guidance on the recognition of provisions associated with restructuring is found in IPSAS 19. Simply because a restructuring involves the disposal of a component of an entity, this does not in itself bring into question the entity's ability to continue as a going concern. However, where a restructuring announced after the reporting date means that an entity is no longer a going concern, the nature and amount of assets and liabilities recognized may change.	May contradict the approach in the CP that entities should account as going concerns between announcement of amalgamation and implementation.
14.31	The following are examples of non-adjusting events after the reporting date that would generally result in disclosure: ... (g) Announcing, or commencing the implementation of, a major restructuring (see IPSAS 19); ...	No change required as appropriate to disclose this information for a combination.
17.34	Recognition of costs in the carrying amount of an item of property, plant, and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant, and equipment: ... (c) Costs of relocating or reorganizing part or all of the entity's operations.	No change required

IPSAS	Text	Comment
18.57	IPSAS 1 requires that when items of revenue or expense are material, their nature and amount of such items are disclosed separately. IPSAS 1 identifies a number of examples of such items, including write-downs of inventories and property, plant, and equipment; provisions for restructurings; disposals of property, plant, and equipment; privatizations and other disposals of long-term investments; discontinued operations; litigation settlements; and reversals of provisions. The encouragement in paragraph 56 is not intended to change the classification of any such items or to change the measurement of such items. The disclosure encouraged by that paragraph, however, does change the level at which the significance of such items is evaluated for disclosure purposes from the entity level to the segment level.	No change required
19.1	An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for provisions, contingent liabilities, and contingent assets, except: ... (g) Those arising from employee benefits, except employee termination benefits that arise as a result of a restructuring, as dealt with in this Standard.	No change required as combinations standard will not cover termination benefits.
19.6	This Standard applies to provisions for restructuring (including discontinued operations). In some cases, a restructuring may meet the definition of a discontinued operation. Guidance on disclosing information about discontinued operations can be found in IFRS 5, <i>Non-current Assets Held for Sale and Discontinued Operations</i> .	Need to consider how this relates to cost of combinations.
19.18	The following terms are used in this Standard with the meanings specified: ... A restructuring is a program that is planned and controlled by management, and materially changes either: (a) The scope of an entity's activities; or (b) The manner in which those activities are carried out.	Need to consider if any change is required to this definition as this is wide enough to include combinations.

IPSAS	Text	Comment
19.81	<p>The following are examples of events that may fall under the definition of restructuring:</p> <p>(a) Termination or disposal of an activity or service;</p> <p>(b) The closure of a branch office or termination of activities of a government agency in a specific location or region, or the relocation of activities from one region to another;</p> <p>(c) Changes in management structure, for example, eliminating a layer of management or executive service; and</p> <p>(d) Fundamental reorganizations that have a material effect on the nature and focus of the entity's operations.</p>	<p>Need to consider if any change is required to this paragraph as this is wide enough to include combinations.</p>
19.82-19.96	<p>A provision for restructuring costs is recognized only when the general recognition criteria for provisions set out in paragraph 22 are met. Paragraphs 83–96 set out how the general recognition criteria apply to restructurings.</p> <p>[See IPSAS 19 for detailed requirements]</p>	<p>Paragraphs 83-96 set out details and clearly include combinations. Need to review to see if these provisions are appropriate. There may be an overlap with costs of a combination UCC; in NUCC these are transferor costs.</p>
21.27	<p>In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:</p> <p>Internal sources of information</p> <p>...</p> <p>(d) Significant long-term changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, or plans to dispose of an asset before the previously expected date and reassessing the useful life of an asset as finite rather than indefinite;</p> <p>...</p>	<p>May contradict the approach in the CP that entities should account as going concerns between announcement of amalgamation and implementation.</p>

IPSAS	Text	Comment
21.43	<p>Costs of disposal, other than those that have been recognized as liabilities, are deducted in determining fair value less costs to sell. Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits (as defined in IPSAS 25, Employee Benefits,) and costs associated with reducing or reorganizing a business following the disposal of an asset, are not direct incremental costs to dispose of the asset.</p>	No change required.
21.60	<p>In assessing whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:</p> <p>Internal sources of information</p> <p>...</p> <p>(c) Significant long-term changes with a favorable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used or is expected to be used. These changes include costs incurred during the period to improve or enhance an asset's performance or restructure the operation to which the asset belongs;</p> <p>...</p>	No change required.
21.63	<p>A commitment to discontinue or restructure an operation in the near future is an indication of a reversal of an impairment loss of an asset belonging to the operation, where such a commitment constitutes a significant long-term change, with a favorable effect on the entity, in the extent or manner of use of that asset. Circumstances where such a commitment would be an indication of reversal of impairment often relate to cases where the expected discontinuance or restructuring of the operation would create opportunities to enhance the utilization of the asset. An example is an x-ray machine that has been underutilized by a clinic managed by a public hospital and, as a result of restructuring, is expected to be transferred to the main radiology department of the hospital where it will have significantly better utilization. In such a case, the commitment to discontinue or restructure the clinic's operation may be an indication that an impairment loss recognized for the asset in prior periods may have to be reversed.</p>	No change required.

IPSAS	Text	Comment
23.6	<p>Governments may reorganize the public sector, merging some public sector entities, and dividing other entities into two or more separate entities. An entity combination occurs when two or more reporting entities are brought together to form one reporting entity. These restructurings do not ordinarily involve one entity purchasing another entity, but may result in a new or existing entity acquiring all the assets and liabilities of another entity. The IPSASB has not addressed entity combinations, and has excluded them from the scope of this Standard. Therefore, this Standard does not specify whether an entity combination, which is a non-exchange transaction, will give rise to revenue or not.</p>	<p>Consequential amendment required to refer to a new IPSAS.</p>
25.131	<p>A curtailment occurs when an entity either:</p> <p>(a) Is demonstrably committed to make a significant reduction in the number of employees covered by a plan; or</p> <p>(b) Amends the terms of a defined benefit plan so that a significant element of future service by current employees will no longer qualify for benefits, or will qualify only for reduced benefits.</p> <p>A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan, or a reduction in the extent to which future salary increases are linked to the benefits payable for past service. Curtailments are often linked with a restructuring. When this is the case, an entity accounts for a curtailment at the same time as for a related restructuring.</p>	<p>No change required as appropriate to account for a curtailment if this results from a combination.</p>
26.25	<p>In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:</p> <p>Internal sources of information</p> <p>...</p> <p>(e) Significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or the manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite;</p> <p>...</p>	<p>May contradict the approach in the CP that entities should account as going concerns between announcement of amalgamation and implementation.</p>

IPSAS	Text	Comment
26.41	<p>Costs of disposal, other than those that have been recognized as liabilities, are deducted in determining fair value less costs to sell. Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits and costs associated with reducing or reorganizing a business following the disposal of an asset are not direct incremental costs to dispose of the asset.</p>	No change required.
26.46	<p>In measuring value in use, an entity shall:</p> <p>...</p> <p>(b) Base cash flow projections on the most recent financial budgets/forecasts approved by management, but shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified;</p> <p>...</p>	No change required.
26.57	<p>Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:</p> <p>(a) A future restructuring to which an entity is not yet committed; or</p> <p>(b) Improving or enhancing the asset's performance.</p>	No change required.
26.58	<p>Because future cash flows are estimated for the asset in its current condition, value in use does not reflect:</p> <p>(a) Future cash outflows or related cost savings (for example, reductions in staff costs) or benefits that are expected to arise from a future restructuring to which an entity is not yet committed; or</p> <p>(b) Future cash outflows that will improve or enhance the asset's performance or the related cash inflows that are expected to arise from such outflows.</p>	No change required.

IPSAS	Text	Comment
26.59	A restructuring is a program that is (a) planned and controlled by management, and (b) materially changes either the scope of the entity's activities or the manner in which those activities are carried out. IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets, contains guidance clarifying when an entity is committed to a restructuring.	Any changes dependent on whether IPSAS 19 is amended.
26.60	<p>When an entity becomes committed to a restructuring, some assets are likely to be affected by this restructuring. Once the entity is committed to the restructuring:</p> <p>(a) Its estimates of future cash inflows and cash outflows for the purpose of determining value in use reflect the cost savings and other benefits from the restructuring (based on the most recent financial budgets/forecasts approved by management); and</p> <p>(b) Its estimates of future cash outflows for the restructuring are included in a restructuring provision in accordance with IPSAS 19.</p>	May contradict the approach in the CP that entities should account as going concerns between announcement of amalgamation and implementation.
26.100	<p>In assessing whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:</p> <p>Internal sources of information</p> <p>...</p> <p>(d) Significant changes with a favorable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or the manner in which, the asset is used or is expected to be used. These changes include costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs;</p> <p>...</p>	No change required.

IPSAS	Text	Comment
29.B.15	<p>Definition of Held-to-Maturity Financial Assets: Permitted Sales</p> <p>Would sales of held-to-maturity financial assets due to a change in management compromise the classification of other financial assets as held to maturity?</p> <p>Yes. A change in management is not identified under IPSAS 29.AG35 as an instance where sales or transfers from held-to-maturity do not compromise the classification as held to maturity. Sales in response to such a change in management would, therefore, call into question the entity's intention to hold investments to maturity.</p> <p>To illustrate: Entity X has a portfolio of financial assets that is classified as held to maturity. In the current period, at the direction of the governing body, the senior management team has been replaced. The new management wishes to sell a portion of the held-to-maturity financial assets in order to carry out an expansion strategy designated and approved by the governing body. Although the previous management team had been in place since the entity's inception and Entity X had never before undergone a major restructuring, the sale nevertheless calls into question Entity X's intention to hold remaining held-to-maturity financial assets to maturity.</p>	<p>No change required as the example does not refer to a combination, and the principle would apply equally if it did.</p>
29.IE45	<p>In 201Z there has been a further downturn in the motor manufacturing sector affecting Entity C. Entity C is seeking bankruptcy protection and has defaulted on the first repayment of principal, although it has met its obligations for interest payments. Government A determines that Entity C is unlikely to recover, but negotiations are advanced with a potential acquirer (Entity D), which will restructure Entity C. Entity D has indicated that it will assume responsibility for the final instalment of the loan with Entity B, but not the initial instalment. Government A recognizes an expense and liability for 25 million CUs and discloses a contingent liability of 25 million CUs.</p>	<p>Not a public sector combination. No change required.</p>

IPSAS	Text	Comment
31.67	<p>In some cases, expenditure is incurred to provide future economic benefits or service potential to an entity, but no intangible asset or other asset is acquired or created that can be recognized. In the case of the supply of goods, the entity recognizes such expenditure as an expense when it has a right to access those goods. In the case of the supply of services, the entity recognizes the expenditure as an expense when it receives the services. For example, expenditure on research is recognized as an expense when it is incurred (see paragraph 52). Other examples of expenditure that is recognized as an expense when it is incurred include:</p> <p>(d) Expenditure on relocating or reorganizing part or all of an entity.</p>	<p>No change required as this relates to transferor accounting and so doesn't conflict with potential goodwill requirements.</p>

APPENDIX B

CONSULTATION PAPER, *PUBLIC SECTOR COMBINATIONS* LIST OF RESPONDENTS

Response #	Respondent Name	Country	Function
001	Financial Management Standards Board (FMSB) of the Association of Government Accountants (AGA)	USA	Other
002	Cour des comptes	France	Audit Office
003	Conseil de normalisation des comptes publics (CNOCP)	France	Standard Setter/Standards Advisory Body
004	Charity Commission for England and Wales	UK	Other
005	Accounting and Auditing Standards Desk of the Abu Dhabi Accountability Authority (ADAA)	United Arab Emirates	Standard Setter/Standards Advisory Body
006	Australian Accounting Standards Board (AASB)	Australia	Standard Setter/Standards Advisory Body
007	Ernst & Young	International	Accountancy Firm
008	Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC)	Australia	Preparer
009	The Japanese Institute of Certified Public Accountants (JICPA)	Japan	Member or Regional Body
010	Staff of the Accounting Standards Board	South Africa	Standard Setter/Standards Advisory Body
011	Australasian Council of Auditors-General (ACAG)	Australia	Audit Office
012	Chartered Institute of Public Finance and Accountancy (CIPFA)	UK	Member or Regional Body
013	Direction Générale des Finances Publiques (DGFIP)	France	Preparer
014	The Accounting Officer of the Commission, European Commission, DG Budget	Europe	Preparer
015	Office of the Comptroller General, Treasury Board of Canada	Canada	Preparer

Response #	Respondent Name	Country	Function
016	Institut der Wirtschaftsprüfer (IDW)	Germany	Member or Regional Body
017	Institute of Certified Public Accountants of Kenya (ICPAK)	Kenya	Member or Regional Body
018	Institute of Chartered Accountants of Nigeria (ICAN)	Nigeria	Member or Regional Body
019	CPA Australia and the Institute of Chartered Accountants in Australia (ICAA)	Australia	Member or Regional Body
020	Staff of the Public Sector Accounting Board (PSAB)	Canada	Standard Setter/Standards Advisory Body
021	Zambia Institute of Chartered Accountants (ZICA)	Zambia	Member or Regional Body
022	The Public Sector Committee of the Institute of Chartered Accountants of Scotland (ICAS)	UK	Member or Regional Body
023	New Zealand Accounting Standards Board (NZASB)	New Zealand	Standard Setter/Standards Advisory Body
024	Denise Silva Ferreira Juvenal	Brazil	Other
025	Swiss Public Sector Financial Reporting Advisory Committee (SRS-CSPCP)	Switzerland	Standard Setter/Standards Advisory Body
026	The Committee on Accounting for Public Benefit Entities (CAPE) of the Financial Reporting Council (FRC)	UK	Standard Setter/Standards Advisory Body