



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

545 Fifth Avenue, 14th Floor
Tel: (212) 286-9344
New York, New York 10017
Fax: (212) 286-9570
Internet: <http://www.ifac.org>

Agenda Item 6

Date: February 28, 2012
Memo to: Members of the IPSASB
From: Annette Davis
Subject: Public Sector Combinations

Objective of this Session

- To **discuss** and **provide directions** on the draft Consultation Paper, *Public Sector Combinations*.

Agenda Material

6.1 Draft Consultation Paper, *Public Sector Combinations*

Draft Consultation Paper, *Public Sector Combinations*

1. Agenda Paper 6.1 is the draft Consultation Paper (CP). The draft CP includes Section 7 on public sector combinations (PSCs) under common control (UCC).
2. The draft CP includes a “potential preliminary view” **only** where the IPSASB has formed a view at previous meetings. The text immediately below the title of the preliminary view indicates the meeting at which the view was formed. Obviously, where the IPSASB agrees that it would be better not to include a view, these can be deleted.
3. Appendix A includes an extract of the draft minutes from the December 2011 meeting relating to public sector combinations.

Draft Flow Chart

4. Appendix B includes a draft Flow Chart illustrating PSCs. Staff would like to acknowledge the help of Stefan Berger in drafting this Flow Chart. Depending on comments received, Staff intend to include this Flow Chart in the CP as an appendix.

Appendix A: Extract from Draft Minutes of December 2011 Meeting

2. ENTITY COMBINATIONS

Discuss issues (Agenda Item 2)

Working definitions

The staff presented an issues paper which proposed revisions to the definitions related to entity combinations.

A Member noted that, although the working definition of an entity combination refers to “entities and/or operations” and the term “operation” is defined, “entity” has not been defined. This Member considers that it is not necessary to distinguish between entities and operations because an operation encompasses both “part of an entity” and an “entity”. The Member suggested that the working definition of an entity combination include only the term “operation”. The IPSASB agreed with this change.

This would then mean that the title of the project “entity combination” would not be appropriate and a different title should be found. After Members found the title “operation combinations” to be unsuitable, a Member suggested that the title could be “public sector combinations”. The IPSASB agreed to consider the project title further.

Staff proposed that the working definition of an operation include circumstances where there are (1) activities and assets, or (2) activities and assets and liabilities. This would mean that “activities and liabilities” would not meet the definition of an operation and thus be outside the scope of the project. A Member commented that public sector entities do acquire operations comprising activities and liabilities and was concerned that these types of acquisitions would be excluded from the scope of the project. Another Member commented that they should be addressed and that the definition of “operation” could be amended to “an integrated set of activities together with assets and/or liabilities...” The IPSASB agreed that operations comprising activities and liabilities should be included within the definition of an operation and thus within the scope of the project.

At the September 2011 meeting, the IPSASB agreed to explore replacing the term “control” with the more expansive phrase such as that used in the Conceptual Framework project Exposure Draft 1 (CF—ED1)¹, in the definitions of “acquisition” and “amalgamation”. Paragraphs 10–31 of Agenda Paper 2.1 outline this proposal. A Member commented that the IPSASB made a conscious decision in CF—ED1 to use a description of control rather than the term itself. The Member is concerned that using the term “control” in this project would not be consistent with the direction of the Conceptual Framework project. Another Member considers that consistency with IPSAS 6, *Consolidated and Separate Financial Statements* is more important at this point in

¹ Paragraph 4.9 of CF—ED1 states:

“The disclosure of information about the resources, obligations and service delivery or other activities that a government as a whole (or other public sector entity) has the authority and capacity to direct, including those it can direct through other entities, will be necessary for accountability and decision-making purposes when the results of such direction can generate benefits for the government (or other public sector entity) or expose it to a financial burden or loss.”

time because of the close relationship between an entity combination and consolidation of a controlled entity. It is IPSAS 6 that defines the term “control” so that an entity can determine which entities are controlled and therefore this project should use the same term to determine whether an entity has gained control of another entity or operation. The IPSASB agreed that the term “control”, as it is defined in IPSAS 6, should be used in this project. Members also agreed that the Introduction to the Consultation Paper should explain why the term “control” is used and that this does not pre-empt decisions in the Conceptual Framework project relating to the reporting entity². Once the Conceptual Framework project is finished, the IPSASB will review its existing standards to determine whether there are inconsistencies that need to be addressed.

Draft Consultation Paper

Section 2: Scope and definitions

A Member suggested that the scope and definitions section of the draft CP should explore issues before going into the detail of the definitions because this gives context to the definitions. In particular, issues relating to (1) the difference between acquisitions of assets and liabilities, and acquisitions of operations, (2) the difference between exchange and non-exchange entity combinations, and (3) the difference between control and common control should be addressed in the scope section.

Another Member suggested that the scope section should also explain what is not in the scope of the draft CP.

The IPSASB discussed the inclusion of acquisitions of joint ventures in the scope of the draft CP. They considered that this complicated the draft CP and agreed that the draft CP should exclude from its scope acquisitions of joint ventures (as well as the formation of joint ventures). This has the consequence of deleting paragraphs 4.58 and 4.59 relating to the accounting treatment for the acquisition of a joint venture and paragraphs A5 and A6 in Appendix A.

Members made comments on specific paragraphs:

- **Paragraph 2.3:** The explanation of why the IASB decided to require a single method of accounting for business combinations is not detailed enough for a reader to understand why the IASB reached this decision. Business combinations for profit-oriented entities are similar in nature in that consideration is almost always transferred and so a single method of accounting is appropriate.
- **Paragraph 2.23:** The definition of common control includes the phrase “combining entities” and the word “combining” needs to be deleted, otherwise the definition does not include acquisitions.

Section 3: Methods of Accounting for Entity Combinations and Measurement Bases

A Member suggested that the discussion relating to measurement bases in Section 4 is generic and therefore would be better placed in Section 3 because the methods of accounting use either carrying amount or fair value. The IPSASB agreed with this suggestion.

² Other aspects of the Conceptual Framework project (e.g., the definitions of elements) may also have implications for any final standard arising from this project.

A Member considered that the sub-section relating to the cost measurement basis (paragraphs 3.22–3.24) did not seem to be leading anywhere and so should be deleted. Another Member considered that the Potential Preliminary View may not be correct in all situations and so should be deleted. The IPSASB agreed that this sub-section should be removed in its entirety (i.e., paragraphs 3.21–3.25).

Members made comments on specific paragraphs:

- **Paragraph 3.4:** The explanation of the acquisition method in IFRS 3, *Business Combinations* should be expanded to explain that it is identifiable assets and liabilities that the acquirer recognizes and not just the assets and liabilities recognized by the newly controlled entity or operation.
- **Paragraph 3.6:** This paragraph explains in detail a requirement of an IPSAS. Rather the requirement should be explained at a high level. Other paragraphs that refer to requirements in IPSASs in detail should also be amended.
- **Paragraph 3.8:** The first sentence is circular and should be amended or deleted.
- **Paragraphs 3.11 and 3.12:** These paragraphs need to be expanded to explain that a resulting entity may need to restate amounts to align the accounting policies of the combining entities with its accounting policies.
- **Paragraph 3.17, Table 3:** The measurement basis of the pooling method needs to be amended to reflect the previous bullet point.
- **Paragraph 3.17, Table 3:** The “surplus or deficit in year of the entity combination” and “accumulated surplus or deficit” of the purchase or acquisition method needs to be amended as the “plus” is not correct.

Section 4: Entity combinations not under common control (ECNUCC): Acquisitions

A Member proposed that the section on entity combinations not under common control: acquisitions should be further divided into two sub-sections, (1) acquisitions where consideration is transferred (including bargain purchases) and (2) acquisitions where no consideration (or nominal consideration) is transferred. This Member is concerned that the draft CP does not sufficiently address the different nature of an acquisition where no consideration is transferred and the current draft of the CP considers them as similar in nature to acquisitions where consideration is transferred. Another Member expressed concern that acquisitions should not be split into categories and considered there should be no difference in their treatment. This Member gave an example of a government bailing out a private sector entity in financial distress and consideration of CU1 is transferred (in substance no consideration), and noted that transfers for no consideration are not unique to the public sector. The IPSASB agreed that the suggestion to split acquisitions into two sub-sections should be explored in the draft CP and that the different views expressed should be addressed.

A Member considered that an explanation needs to be included in the introduction to this section to explain why the IPSASB made the decision to split entity combinations between ECNUCC and entity combinations under common control (ECUCC). The IPSASB agreed with this suggestion.

The IPSASB discussed how this section should be reordered. Members considered that the order should be as follows:

- (1) Which approach (method of accounting) responds to user needs and satisfies the objectives of financial reporting for the transaction or other event that has happened;
- (2) Which measurement basis is appropriate, i.e., is able to provide this information; and
- (3) Does that measurement basis meet the qualitative characteristics?

Additionally, a Member suggested that the measurement bases need to be more clearly linked with the methods of accounting. Another Member suggested the focus should be on reflecting the substance of the transaction or other event rather than just being a debate about the use of carrying amount or fair value.

A Member commented that the draft CP does not discuss issues relating to the acquisition of entities that are not on an accrual basis of accounting. The Chairman commented that this issue relates to an entity moving to an accrual basis rather than an entity combination issue. The IPSASB agreed that this issue should be included in the draft CP by reference to the IPSASB's "First-Time Adoption of IPSASs" project and Study 14, *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities (Third Edition)* issued in January 2011.

Goodwill

The IPSASB discussed the sub-section relating to the accounting treatment of the difference arising where the consideration transferred is in excess of the net assets acquired (paragraphs 4.35–4.43). A Member asked whether the draft CP should use the term "goodwill". Other Members responded that it was useful to include this term, and the introductory paragraph 4.35 should be amended to reflect wording along the lines of "an asset (sometimes referred to as goodwill)".

A Member commented that IFRS 3 determines that the residual is goodwill and then that goodwill is assessed for impairment. This is in contrast to the draft CP which starts off with the residual being a loss or goodwill. This Member considered that the reason for the difference in approach should be explained. Another Member asked whether this difference in approach would result in the same answer in all instances? If so, why is the draft CP taking a different approach? Another Member considered that it is likely that an acquirer in the public sector would look first at whether the difference arising was a loss and then look at whether it was goodwill. Another Member considered that the different approach, where it leads to the same answer as that in IFRS 3, might give a different impression. In other words, a "loss" might be considered to be different from an "impairment loss on goodwill".

An Observer commented that the *System of National Accounts* (SNA) defines goodwill very narrowly as being restricted to acquisitions of entities where there is an obvious market sale³.

Acquisitions of entities in financial distress

The IPSASB agreed that this sub-section (paragraphs 4.53–4.57) should be removed. A Member considered that the issues relating to these entities relate to measurement on acquisition and

³ The definition in SNA (2008) is: "Goodwill and market assets" –The value of goodwill and marketing assets is defined as the difference between the value paid for an enterprise as a going concern and the sum of its assets less the sum of its liabilities, each item of which has been separately identified and valued."

whether the acquired entity should be consolidated. A Member suggested that how these issues should be addressed could be a part of the Work Plan discussion at the March 2012 meeting.

Issues relating to recognition

The IPSASB agreed that the draft CP should include a sub-section on recognition, including issues relating to determining the acquisition date.

Other comments on Section 4

Members made comments on specific paragraphs:

- **Paragraph 4.4:** The explanation of the approaches explored and discarded needs to be expanded, acknowledging that changes will also occur because of the decision to explore whether acquisitions can be divided into sub-sections as discussed in the previous paragraph.
- **Paragraph 4.5:** An explanation needs to be included on why only three qualitative characteristics and one constraint are used to assess the measurement bases.
- **Paragraph 4.12:** The assertion that fair value provides useful information about the service capacity of non-cash-generating assets needs to be expanded to explain why this is the case. There are also other paragraphs that include unsupported assertions and these paragraphs need to be amended to include an explanation for the assertion.
- **Paragraphs 4.15:** This paragraph includes another unsupported assertion. Carrying amount is not always easily verifiable (e.g., where an entity does not have records of its acquisitions of assets). Further, the phrase “resources expended to obtain those assets...” needs to be expanded to specify that it is the newly controlled entity that expended these resources before it was acquired.
- **Paragraph 4.27:** This paragraph is an unsupported assertion and does not lead anywhere and therefore needs to be amended or deleted.
- **Paragraph 4.28, second sentence:** The wording needs to be clarified relating to assets and liabilities recognized before the newly controlled entity or operation is acquired.
- **Paragraph 4.29, second sentence:** This sentence is true only in instances where the consideration is less than the net assets acquired and therefore the sentence needs to be amended.
- **Paragraph 4.30(a):** The “plus” should be a “minus” in relation to the inclusion of the minority interest in the calculation.
- **Paragraph 4.38:** This paragraph should be reordered so that it is explained that all identifiable assets and liabilities are recognized and if there is a residual and the amount of consideration is higher than the amount of the residual, then goodwill arises.
- **Paragraph 4.39:** This paragraph uses the term “overpayment”. A Member is concerned that in his jurisdiction overpayments are illegal and would rather it was described as a deliberate action on behalf of the acquirer to provide a subsidy to the previous owners. The Chairman added that an overpayment could also be a genuine error. Another Member suggested from the second sentence that the phrase “and would therefore simply be an overpayment” should be omitted. Another Member noted that applying the distinction between cash-generating assets and non-cash-generating assets in this context is not quite correct because assets can generate cash, but not be held for a commercial return. The distinction should be whether the asset is held with the primary objective of making a commercial return. The IPSASB agreed that different terminology should be used and that this paragraph needs to be amended so that its purpose is clear.

- **Paragraphs 4.45 and 4.46:** Another option should be added: the difference arising is a loss unless an entity can demonstrate it can meet certain criteria. The option of a free choice should be deleted.
- **Paragraph 4.47, Table 4:** The acronyms should be deleted and the full phrase inserted.
- **Paragraph 4.67:** The last sentence should be deleted.

Section 5: Entity combinations not under common control (ECNUCC): Amalgamations

The IPSASB discussed whether a sub-section on determining the boundary between acquisitions and amalgamations is necessary. A Member suggested that the definitions are clear and so additional criteria are not necessary. Another Member suggested that if the criteria noted in paragraphs 5.4 are relevant, a link needs to be made between the definition and these criteria. Another Member suggested that rather than focusing on whether control exists, this section should focus on whether an acquirer can be identified. The IPSASB agreed that these points should be incorporated into this sub-section.

The IPSASB noted that this section would be reordered in the same way as agreed for Section 4.

Other comments on Section 5

Members made comments on specific paragraphs:

- **Paragraph 5.3:** This paragraph should be amended to include an explanation of why a higher level of government may be able to impose an amalgamation on a lower level of government where it does not control the lower level of government (i.e., because of the higher level's regulatory role). The explanation of the approaches explored and discarded needs to be expanded, acknowledging that changes will also occur because of the decision to explore whether acquisitions can be divided into sub-sections as discussed in the previous paragraph.
- **Paragraph 5.4:** This paragraph should be amended to explain the private sector differences in more detail. In addition, it should explain that the IASB decided that an acquirer could always be identified.
- **Paragraphs 5.5 and 5.6:** The references to ownership "interests" should be amended to "instruments".
- **Paragraph 5.41, Potential Preliminary View:** The wording of the potential preliminary view needs to be improved.

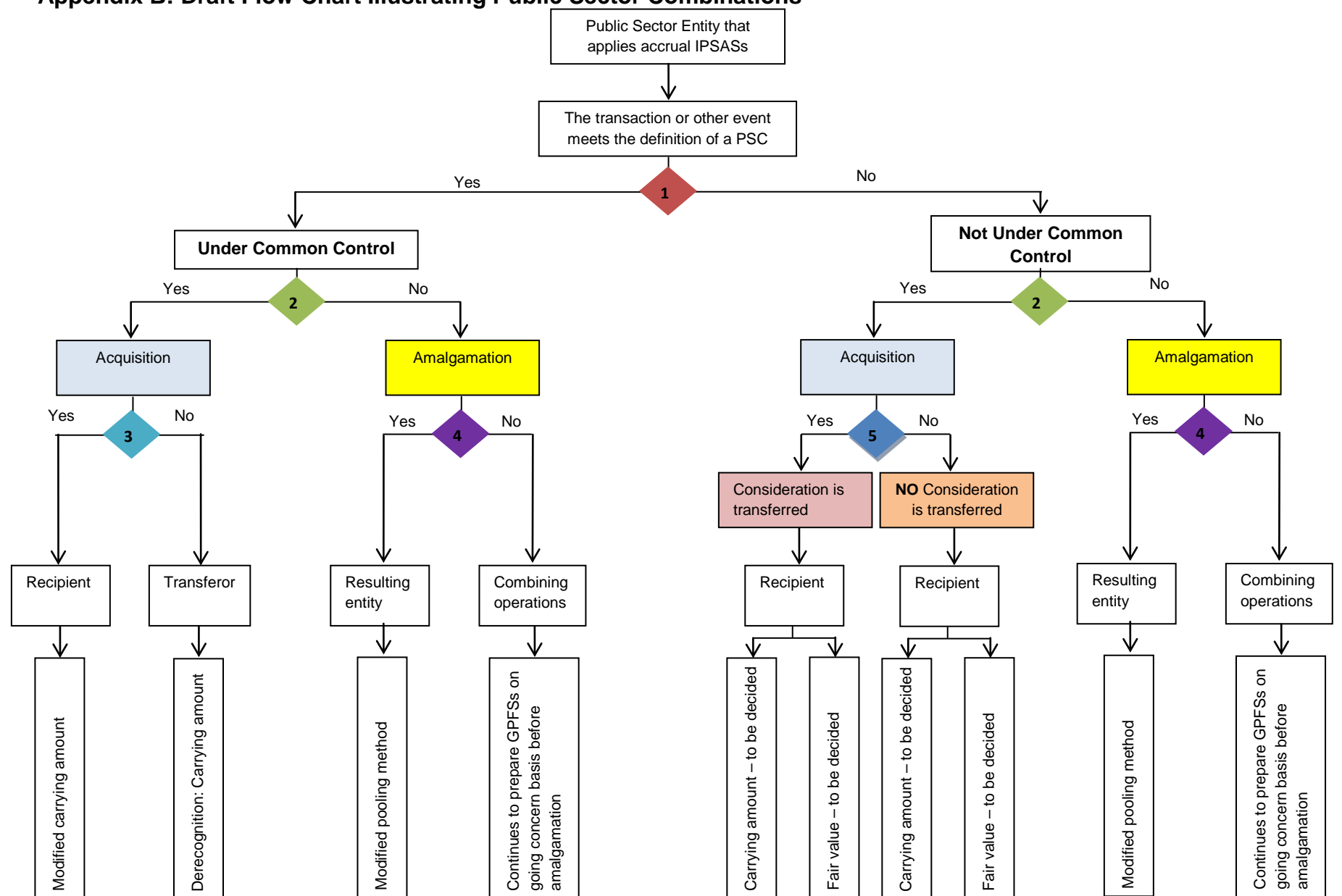
Appendix B: Entity Combinations Flow Chart

A Member commented that the text relating to the "difference arising" is incorrect and needs to be fixed. Another Member commented that the lines linking the boxes in the flow chart are not always intuitive and need to be improved.

Next steps

The staff noted a draft CP will be presented at the March 2012 IPSASB meeting amended for the above comments and including the sections on entity combinations under common control.

Appendix B: Draft Flow Chart Illustrating Public Sector Combinations



Does this occur within an economic entity, i.e., under common control?



Does this Public Sector Combination (PSC) meet the definition of an acquisition?



Is this the recipient?



Is this the resulting entity?



Is Consideration transferred?

DRAFT CONSULTATION PAPER PUBLIC SECTOR COMBINATIONS

	Page
1 Introduction	4
History of the Project	5
2 Public Sector Combinations—Scope and Definitions.....	6
Public Sector Combinations	6
Distinction between PSCs under Common Control and those not under Common Control	6
Types of PSCs: Distinction between Acquisitions and Amalgamations	8
The Parties to a PSC which are in the Scope of the CP	9
PSCs NUCC.....	9
PSCs UCC	9
Summary.....	10
Scope Exclusions	10
Acquisitions of Assets	10
Formation or Acquisition of a Joint Venture	11
Definitions	11
PSC	11
Common Control	12
Acquisition	12
Control.....	12
Amalgamation	13
3 Methods of Accounting for PSCs and Measurement Bases	14
Methods of Accounting	14
The Purchase or Acquisition Method	14
Measurement—Fair Value.....	15
The Pooling of Interests Method	16
Measurement—Carrying Amount.....	16
The Fresh Start Method	17
Summary	18
4 The Boundary between Acquisitions and Amalgamations	20
5 Accounting for Public Sector Combinations not under Common Control (PSCs NUCC): Acquisitions.....	22
Introduction	22
What is the Appropriate Method of Accounting?	22
Exchange Transactions and Non-exchange Transactions	22

What is the Appropriate Measurement Basis or Approach?	23
Use of Fair Value as the Measurement Basis for all Acquisitions	23
Potential Distinction between Acquisitions based on whether or not Consideration is Transferred.....	25
Consideration Transferred.....	26
Acquisition does not involve the Transfer of Consideration	27
Treatment of the Difference Arising	27
Treatment of Difference Arising Where Recipient Acquires Net Assets	28
Treatment of Difference Arising Where Recipient Assumes Net Liabilities	30
Acquisition involves the Transfer of Consideration	30
Summary of Potential Distinction between Acquisitions based on whether or not Consideration is Transferred.....	30
Other Issues	31
Presence of Minority Interests	31
Measurement of a Minority Interest	31
Effect of a Minority Interest on the Difference Arising	32
Acquisition-Related Costs	32
6. Accounting for Public Sector Combinations not under Common Control (PSCs NUCC):	
Amalgamations	34
Introduction	34
What is the Appropriate Method of Accounting?	34
Application of the Pooling of Interests Method of Accounting.....	34
Possible Modification to the Pooling of Interests Method.....	34
Application of the Fresh Start Method of Accounting.....	35
Analysis	35
Accounting Treatment in the Combining Operations.....	36
7. Accounting for Public Sector Combinations under Common Control (PSCs UCC):	
Acquisitions and Amalgamations.....	37
Introduction	37
Acquisitions UCC: Recipient Accounting.....	37
What is the Appropriate Measurement Basis or Approach?	37
Treatment of the Difference Arising	38
Acquisitions UCC: Transferor Accounting	38
Existing Requirements	38
What is the Appropriate Measurement Basis or Approach?.....	39
Treatment of the Difference Arising	39

Amalgamations UCC: Resulting Entity Accounting	39
Amalgamations UCC: Combining Operations Accounting	39
Appendix A: Examples of the Scope of this Consultation Paper	41

1 Introduction

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

¹ CF–ED 1, paragraph 2.1.

History of the Project

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

2 Public Sector Combinations—Scope and Definitions

Public Sector Combinations

- 2.1 A public sector combination (PSC) is the bringing together of separate operations into one entity and is not limited to one entity obtaining control of one or more operations. This CP therefore considers the financial reporting of a PSC when:
- (a) An entity gains control of one or more operations (acquisition); and
 - (b) Two or more operations combine with none of the combining operations gaining control of the other operations (amalgamation).
- 2.2 The key issues addressed in this CP are how to account for the effects of a PSC at initial recognition² of the PSC and initial measurement³ in the financial statements⁴ of the entities and/or operations involved. This is discussed in more detail below.
- 2.3 This CP deals with accounting for PSCs not under common control and PSCs under common control, undertaken with or without the transfer of consideration. Appendix A sets out examples of the types of transactions and other events that give rise to a PSC that are included in this CP.

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

- 2.4 A PSC that takes place between controlled entities within an economic entity is characterized as being “under common control” (UCC). In contrast, a PSC that takes place between unrelated parties is characterized as being “not under common control” (NUCC). This section explores whether the differences between these two circumstances should or could lead to differences in the ways in which they are recognized and/or measured for financial reporting purposes.
- 2.5 Entities within an economic entity are related parties.⁵ Other IPSASs do not make a distinction in the accounting treatment of transactions or other events taking place between entities UCC and entities NUCC. The only specific requirements relating to transactions between entities UCC are in IPSAS 20, *Related Party Transactions* which requires supplementary disclosures because the

² Paragraph 6.1 of CF–CP2, *Elements and Recognition in Financial Statements* states that “recognition is the process of incorporating an item that meets the definition of an element and can be measured reliably in the relevant financial statement.”

³ Paragraph 1.1 of CF–CP3, *Measurement of Assets and Liabilities in Financial Statements* states that: “This Consultation Paper explores the measurement bases that may validly be adopted for the elements that are recognized in public sector general purpose financial statements (GPFSS, hereafter financial statements). The term “measurement basis” refers to the concept that is used in determining the amount at which an asset or liability is stated in the financial statements. Examples of measurement bases are historical cost, market value and replacement cost.”

⁴ Throughout this CP, “financial statements” means the general purpose financial statements of a single entity where it is a party to a public sector combination and the consolidated general purpose financial statements where an economic entity is a party to a public sector combination.

⁵ A related party is defined as follows (IPSAS 20, *Related Party Disclosures*, paragraph 4):
“Related party means parties are considered to be related if one party has the ability to (a) control the other party, or (b) exercise significant influence over the other party in making financial and operating decisions, or if the related party entity and another entity are subject to common control. Related parties include:
(a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by, the reporting entity;...”

related party relationship could have an effect on the financial performance and position of an entity.

- 2.6 This situation is the same under International Financial Reporting Standards (IFRSs), except for IFRS 3 which explicitly excludes business combinations under common control from its scope. The IASB is in the process of consulting on its agenda, and, at this stage, it is unclear whether a project to address business combinations under common control will be taken onto its Work Plan. The European Financial Reporting Advisory Group (EFRAG) issued a Discussion Paper (DP), *Accounting for Business Combinations under Common Control* (BCUCC) in October 2011.⁶ EFRAG's DP discusses the issues relating to BCUCC within the framework of applying IFRSs, i.e., it has been developed from the perspective of profit-oriented entities applying IFRSs.
- 2.7 The related party nature of a PSC UCC may affect the nature of the PSC because the ultimate controlling entity of the economic entity may direct the transaction. In instances where the ultimate controlling entity does direct the PSC transaction, its purpose may be to benefit other entities within the economic entity rather than the parties to the PSC. In contrast, a PSC NUCC is more likely to benefit the entities that are a party to it because they initiate the transaction. However, some PSCs NUCC may not be to benefit the parties to the PSC because it is also a directed transaction, e.g., two local government entities are parties to a PSC which is undertaken at the direction of the central government and, in this jurisdiction, the local government is not under the control of the central government. In this situation, rather than the ultimate controlling entity directing the transaction, it is a higher level of government directing a lower level of government, which it does not control.
- 2.8 Another feature of a PSC UCC is that the parties to it will typically have access to information and accounting records related to the PSC. Parties to a PSC NUCC will not usually have access to the same type of information and therefore there will be information asymmetry. The fact that there is no information asymmetry for a PSC UCC may result in a shorter negotiation process than for a PSC NUCC.
- 2.9 The terms and conditions of a PSC UCC may also be affected by the related party nature of the transaction. For example, the ultimate controlling entity may direct an operation comprising net liabilities to be transferred, which is less likely to occur where the parties to a PSC are unrelated. It may also affect whether consideration is transferred and the amount of that consideration.
- 2.10 In summary, the related party nature of a PSC UCC may affect:
- (a) The purpose of a PSC, e.g., it may benefit other controlled entities in the economic entity instead of the parties to the PSC;
 - (b) The terms and conditions may differ from a PSC NUCC because of the related party relationship, e.g., whether consideration is transferred and the amount of that consideration; and
 - (c) The information and accounting records available to the parties to a PSC UCC will usually be more than for a PSC NUCC.

⁶ The DP is accessible on EFRAG's website: www.efrag.org

- 2.11 The IPSASB considers that the related party nature of a PSC UCC is so significant as to warrant the consideration of the accounting issues related to each type of PSC separately.

Types of PSCs: Distinction between Acquisitions and Amalgamations

- 2.12 Once the distinction as to whether a PSC is UCC or NUCC has been made, a further distinction is made based on whether a PSC is an acquisition and an amalgamation.

- 2.13 The IPSASB notes that the IASB, which sets accounting standards for profit-oriented entities, has noted the following in the Basis for Conclusions to IFRS 3 in relation to business combinations:

“Both boards [the IASB and the FASB] concluded that ‘true mergers’ or ‘mergers of equals’ in which none of the combining entities obtains control of the others are so rare as to be virtually non-existent, and many respondents agreed. Other respondents stated that even if a true merger or merger of equals did occur, it would be so rare that a separate accounting treatment is not warranted. The boards also observed that respondents and other constituents were unable to suggest an unambiguous and non-arbitrary boundary for distinguishing true mergers or mergers of equals from other business combinations and concluded that developing such an operational boundary would not be feasible. Moreover, even if those mergers could feasibly be distinguished from other combinations, both boards noted that it does not follow that mergers should be accounted for on a carry-over basis. If they were to be accounted for using a method other than the acquisition method, the fresh start method would be better than the pooling method.”⁷

- 2.14 Consequently, IFRS 3 requires a single method of accounting for business combinations, the acquisition method (described in Section 3). This approach requires that an acquirer is identified for all business combinations.
- 2.15 In contrast, the IPSASB considers that there is a fundamental difference between some types of PSCs and business combinations involving profit-oriented entities because public sector entities do not usually have ownership instruments in the same way as profit-oriented entities. The focus of most PSCs is on the achievement of objectives relating to the delivery of goods and services for community or social benefit, rather than to generate profits. Because of this, public sector entities are not competing with each other to maximize returns to equity holders and so are more likely to be involved in a combination in which no acquirer can be identified. Furthermore, many PSCs do not involve the transfer of consideration. Thus, PSCs in which there is no acquirer or dominant entity occur with sufficient frequency so as to require separate identification of these types of PSC.
- 2.16 Separate identification of acquisitions and amalgamations leads to consideration of whether different accounting treatments may be appropriate to respond to the information needs of users of GPFRs of public sector entities. This CP therefore distinguishes between acquisitions, where one entity gains control of one or more operations, and amalgamations, where operations combine together and none of the combining operations gain control over any of the others. Section 4 explores how to distinguish between acquisitions and amalgamations so that an accounting method can be chosen for each that faithfully represents the economic substance of these transactions or other events.

⁷ IFRS 3, Basis for Conclusions paragraph BC35.

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

PSCs NUCC

- 2.17 The CP considers the accounting treatment in the financial statements of the entity that gains control of one or more operations in a PSC NUCC through an acquisition. The CP does not deal with the accounting treatment in the financial statements of the entity that loses control of one or more operations because IPSASs already include requirements on the accounting treatment in consolidated financial statements where a controlling entity loses control of a controlled entity and in the financial statements of a single entity where that entity loses control of assets or has liabilities extinguished which forms an operation.
- 2.18 For amalgamations, the CP considers the accounting treatment in the financial statements of the entity that is the result of the amalgamation and in the financial statements of the combining operations where those operations prepare and present financial statements using accrual IPSASs.⁸

PSCs UCC

- 2.19 For a PSC UCC, the CP deals with the accounting treatment in the controlled entities within an economic entity, that are a party to the PSC and not the accounting treatment in the financial statements of the economic entity of which they are a part. This is because when the economic entity prepares its consolidated financial statements, the effects of a PSC are eliminated in full.⁹ The controlled entities that are a party to a PSC may be either single entities or economic entities (in other words an intermediate controlling entity). The CP deals with the accounting treatment in the financial statements of a single entity where it is a party to a PSC and the consolidated financial statements where an intermediate economic entity is a party to a PSC. The accounting treatment in the separate financial statements of the intermediate economic entity is not in the scope of this CP. An example of a PSC UCC is where a central government has a department of defense and a department of justice. The department of justice acquires an operation from the department of defense. The accounting treatment of this PSC for these two departments is within the scope of the CP. The accounting treatment of this PSC in the consolidated financial statements of the central government is not in the scope of the CP.
- 2.20 In respect of PSCs UCC which are acquisitions, the CP considers the accounting treatment in the financial statements of:
- (a) The entity that gains control of one or more operations; and
 - (b) The entity that loses control of one or more operations.
- 2.21 For amalgamations UCC, the CP considers the accounting treatment in the financial statements of the entity that is the result of the amalgamation and in the financial statements of the combining operations.

⁸ If these operation do not prepare and present financial statements based on accrual IPSASs then there is no accounting issue under IPSASs because IPSASs apply to financial statements.

⁹ IPSAS 6, paragraph 45.

Summary

2.22 Table 2 below summarizes the parties to a PSC which are in the scope of the CP

Table 2: PSCs in the Scope of the CP

	Acquisition			Amalgamation	
	Recipient	Transferor	Ultimate Economic Entity	Resulting Entity	Combining Operations
NUCC	Yes	No	N/A	Yes	Yes (where they prepare financial statements using accrual IPSASs)
UCC	Yes	Yes	No	Yes	Yes (where they prepare financial statements using accrual IPSASs)

Scope Exclusions

- 2.23 The CP excludes from its scope acquisitions of assets and the formation or acquisition of a joint venture. The reasons for their exclusion are dealt with below. The CP also does not deal with subsequent measurement and disclosures.
- 2.24 The subsequent measurement of a PSC is not discussed in this CP because IPSASs already include requirements on the subsequent measurement of assets, liabilities and equity instruments issued (if any).
- 2.25 The CP does not address the issue of disclosures although information disclosed in the notes is necessary to satisfy the needs of users for accountability and decision-making purposes because the nature of such disclosures will depend upon the approaches adopted for the initial recognition and measurement of a PSC.

Acquisitions of Assets

- 2.26 The CP excludes from its scope (1) acquisitions of assets, i.e., the gaining of control of an asset or a group of assets and (2) the combining together of assets or groups of assets, where the acquisition or combining of the asset or group of assets does not also include related activities. This is because IPSASs already include requirements on the accounting treatment of these types of transactions or other events.
- 2.27 Similarly, the CP also excludes from its scope, the assumption of liabilities where that liability does not also include related activities, for the same reason given above for assets.

Formation or Acquisition of a Joint Venture

- 2.28 A transaction or other event that results in the formation or acquisition of a joint venture may also meet the definition of a PSC. This may occur when a venturer¹⁰ forms or acquires a joint venture and that joint venture comprises activities and related assets and/or liabilities.
- 2.29 The CP excludes from its scope formation or acquisition of a joint venture. Accounting requirements for the formation of joint ventures is addressed in IPSAS 8, *Interests in Joint Ventures*. Accounting requirements for the acquisition of joint ventures will be considered in the project on the *Revision of IPSASs 6–8*.

Definitions

- 2.30 The paragraphs below explain the definitions used in this CP and how they reflect the scope.

PSC

- 2.31 This CP uses an overarching definition of a PSC to describe two types of PSC in its scope:
- “A public sector combination is the bringing together of separate operations into one entity either as an acquisition or an amalgamation.”
- 2.32 The term “operation” is used so that a PSC can be differentiated from the acquisition or combining of an asset or group of assets because an operation must include “activities.” An operation can include (1) activities and assets, (2) activities and liabilities or (3) activities and assets and liabilities.
- 2.33 In addition, the use of the term operation means that a PSC can involve the acquisition of an entity, or a component or part of an entity, or the combining together of several components from separate entities, into one entity.
- 2.34 Therefore, an “operation” is defined as:
- “An integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving the entity’s objectives, either by providing economic benefits or service potential.”
- 2.35 The definition of operation is based upon the term “business” from IFRS 3. The definition of business is:
- “An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.”
(IFRS 3, Appendix A)
- 2.36 For application in the public sector, the term “business” has been amended to “operation” has been amended to:
- (a) Include the notion of the provision of goods and services rather than providing a return in the form of dividends because this is a major activity of most public sector entities – this has been achieved by the use of the phrase “either by providing economic benefits or service potential”; and

¹⁰ A venturer “is a party to a joint venture and has joint control over that joint venture.”

- (b) Acknowledge that a public sector operation may involve activities directed at the management of liabilities rather than use of assets for the delivery of services – this has been achieved by the use of the phrase “activities and related assets and/or liabilities.”

Common Control

2.37 This CP deals with acquisitions or amalgamations of operations that are under common control.

This CP defines common control as:

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

Acquisition

2.38 An acquisition is defined as:

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

Control

2.39 The term control used in this definition is the same as that used in IPSAS 6, *Consolidated and Separate Financial Statements* because of the close relationship between a PSC and consolidation of a controlled entity. IPSAS 6 defines the term “control” as “the power to govern the financial and operating policies of another entity so as to benefit from its activities.”

2.40 The IPSASB has two other projects that may impact on the use of the term control and its definition in this project. The first is its *Conceptual Framework* project. The Phase 1 Conceptual Framework Exposure Draft 1 (CF–ED1) does not define or use the term control¹¹ when exploring the underlying principles of a group reporting entity (CF–ED1 uses “group reporting entity” instead of “economic entity”). The use of the IPSAS 6 definition of control in this CP does not pre-empt decisions in the Conceptual Framework project relating to the reporting entity.¹² Once this project is completed, the IPSASB will review its existing standards to determine whether there are inconsistencies that need to be addressed.

2.41 The second project that may have implications on the definition of control is the *Revision of IPSASs 6–8*. This project includes in its scope a review of the definition and use of the term “control.” The outcome of the *Revision of IPSASs 6–8* project will determine whether consequential changes will need to be made to any final standard arising from this project.

2.42 Because both projects are at different stages, the IPSASB concluded that this CP should use the definition of control in the existing IPSAS 6.

¹¹ Paragraph 4.9 of CF–ED1 states:

“The disclosure of information about the resources, obligations and service delivery or other activities that a government as a whole (or other public sector entity) has the authority and capacity to direct, including those it can direct through other entities, will be necessary for accountability and decision-making purposes when the results of such direction can generate benefits for the government (or other public sector entity) or expose it to a financial burden or loss.”

¹² Other aspects of the Conceptual Framework project, e.g., the definitions of elements, may also have implications for any final standard arising from this project.

- 2.43 Where one entity gains control of one or more operations during the reporting period, the entity that loses control of the operation is the *transferor* and the entity that gains control of the operation is the *recipient*. The operation being acquired is the *newly controlled operation*. The definitions of these terms are set out in Table 3 below.

Table 3: Definitions of the Parties in an Acquisition

A newly controlled operation is the operation that a recipient gains control of in an acquisition.
A recipient is the entity that gains control of one or more operations.
A transferor is the entity that loses control of one or more of its operations to another entity (the recipient) in an acquisition.

- 2.44 The terms “recipient” and “transferor” are used in IPSAS 23, *Revenue from Non-exchange Transactions (Taxes and Transfers)*. The entity that transfers assets in a non-exchange transaction to another entity is the transferor and the entity that obtains the transfer is the recipient. The IPSASB considers that the use of these terms in IPSAS 23¹³ is consistent with the way the terms are used for PSCs in this CP, whether the PSC arises from an exchange or non-exchange transaction.
- 2.45 These terms differ from those used for an acquisition in IFRS 3 because of the differences between public sector acquisitions and business combinations. The terms in IFRS 3 are “acquirer” rather than “recipient” and “acquiree” rather than “newly controlled operation.” IFRS 3 does not define the equivalent of “transferor,” instead it refers to “former owners.”

Amalgamation

- 2.46 The scope of this CP includes PSCs that are amalgamations. An amalgamation is defined as:
“A transaction or other event where two or more operations combine and none of the combining operations gain control of the other operations.”
- 2.47 The entity that is the result of the amalgamation is termed the *resulting entity*. The operations that combine are termed the *combining operations*. The definitions of these terms are set out in Table 4 below.

Table 4: Definitions of the Parties in an Amalgamation

A combining operation is an operation that combines with one or more other operations to form the resulting entity.
A resulting entity is the entity that is the result of two or more operations combining where none of the combining operations gains control of the other operations.

¹³ The *System of National Accounts* (SNA) 2008 also uses the term “transfer” to mean a non-exchange transaction. SNA 2008 defines “transfer” as “a transaction in which one institutional unit provides a good, service or asset to another unit without receiving from the latter any good, service or asset in return as a direct counterpart.”

3 Methods of Accounting for PSCs and Measurement Bases

Methods of Accounting

- 3.1 The following methods of accounting for business combinations in profit-oriented entities that have been applied in practice or have been proposed:
- (a) The purchase or acquisition method;
 - (b) The pooling of interests method; and
 - (c) The fresh start method.
- 3.2 A description of each method and the measurement bases used is set out below. This CP then considers in Chapters 5–7 whether application of these methods are appropriate for accounting for PSCs.

The Purchase or Acquisition Method

- 3.3 A purchase or acquisition method of accounting has been applied in many jurisdictions. This CP describes the method as it is applied in IFRS 3, *Business Combinations*. IFRS 3 uses the term “acquisition method” because a business combination can occur in the absence of a purchase transaction.¹⁴
- 3.4 Under the acquisition method of accounting, one entity (the acquirer) obtains control of a business (the acquiree) in exchange for cash or other consideration. The acquirer recognizes and measures the identifiable assets acquired and the liabilities assumed of the acquiree at their fair value at the date of acquisition. This requirement includes the recognition of identifiable assets and liabilities that were not previously recognized by the acquiree. There are some limited exceptions to this approach to recognition and measurement, e.g., for deferred tax. Goodwill is measured indirectly as the excess of the aggregate of consideration transferred and the amount of non-controlling interests¹⁵ (if any), and the acquisition date amounts of the fair value of the acquiree’s net identifiable assets and liabilities. For example, an acquirer pays CU90 for an 80% interest in a business (the acquiree). The fair value of the identifiable assets and liabilities of the acquiree is CU100. The acquirer recognizes in its financial statements¹⁶ identifiable assets and liabilities of the acquiree at CU100 and a non-controlling interest of CU20 (presented in equity). Goodwill is recognized at CU10 (CU90 being the consideration transferred minus CU80 being the acquirer’s share of the fair value of identifiable assets and liabilities of the acquiree). 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.
- 3.5 The IASB has concluded the following in relation to the use of the acquisition method (including the application of fair values):

¹⁴ IFRS 3, Basis for Conclusions paragraph BC14, 2008.

¹⁵ Also referred to as “minority interests.”

¹⁶ “Financial statements” means the financial statements of a single entity where it is an acquirer and consolidated financial statements where the acquirer is a parent entity.

“...Users of financial statements are better able to assess the initial investments made and the subsequent performance of those investments and compare them with the performance of other entities. In addition, by initially recognising almost all of the assets acquired and liabilities assumed at their fair values, the acquisition method includes in the financial statements more information about the market’s expectation of the value of the future cash flows associated with those assets and liabilities, which enhances the relevance of that information.”¹⁷

- 3.6 To put this statement into context, the IASB’s Conceptual Framework¹⁸ identifies the primary users of general purpose financial reports (GPFRs) as existing and potential investors, lenders and other creditors. The objective of general purpose financial reporting for the IASB is to provide information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling or holding equity and debt instruments, and providing or settling loans and other forms of credit. The IASB’s Conceptual Framework explains that existing and potential investors, lenders and other creditors need information to help them assess the prospects for future net cash inflows to an entity. For this purpose they need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity’s management and governing board have discharged their responsibilities to use the entity’s resources.
- 3.7 In other words, IFRS 3 is consistent with the IASB’s Conceptual Framework in that in that it is clear that the best way to meet the information needs of existing and potential investors, lenders and other creditors is to apply fair value measurement so that information is provided to enable users to assess the prospects for future net cash inflows to an entity as a result of the business combination.

Measurement—Fair Value

- 3.8 The acquisition method of accounting uses fair values and the IPSASB defines fair value as follows:
- “The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.” (IPSAS 9, *Revenue from Exchange Transactions*)
- 3.9 This definition of fair value encompasses the amount that will be derived from an asset either from its use (service potential or economic benefits) or from its sale. 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.
- 3.10 The definition of fair value in IPSAS 9 reflected that used in IFRSs at the time of issue of IPSAS 9. However, the IASB has recently completed its project on fair value measurement and, as a result, has amended its definition of fair value to clarify that fair value is an exit price which is based on a market-based measurement rather than an entity-specific measurement, and takes into account the

¹⁷ IFRS 3, Basis for Conclusions, paragraph BC25.

¹⁸ *Conceptual Framework for Financial Reporting*, IASB, September 2010.

market conditions at the measurement date.¹⁹ If this value cannot be derived from direct observation, it is estimated by reference to hypothetical markets and participants on those markets.

The Pooling of Interests Method

- 3.11 The pooling of interests method of accounting has also been applied in many jurisdictions. This CP describes the pooling of interests method as prescribed in IAS 22, *Business Combinations* issued in October 1998. IAS 22 was superseded by IFRS 3 in March 2004. IFRS 3 prohibits the use of the pooling of interests method.
- 3.12 The pooling of interests method is also known as the uniting of interests method or merger accounting.
- 3.13 The pooling of interests method as prescribed in IAS 22 was limited to business combinations that met the definition of a “uniting of interests.” This situation occurred where it was not possible to identify an acquirer. Instead of a dominant entity emerging, the shareholders of the combining entities join in a substantially equal arrangement to share control over the whole of the net assets and operations of the combined entity. As a result, the shareholders of the combining entities mutually share in the risks and benefits of the combined entity. Therefore, this type of business combination had to be undertaken with a substantially equal exchange of shares between the combining entities.
- 3.14 Where a business combination met the definition of a uniting of interests, it was accounted for using the pooling of interests method. This method required that 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. The combined entity recognizes the assets, liabilities and equity of the combining entities at their existing carrying amounts adjusted only as a result of aligning the combining entities’ accounting policies and applying those policies to all periods presented. There is no recognition of any new goodwill or negative goodwill. For example, Entity A has recognized net assets of CU50 and Entity B has recognized net assets of CU40. Both entities have the same accounting policies. The combined entity recognizes net assets of CU90.
- 3.15 The reasoning for the IASB prohibiting the application of the pooling of interests method of accounting for business combinations is set out in the Basis for Conclusions to IFRS 3 (see also paragraph 2.13 of this CP).

Measurement—Carrying Amount

- 3.16 The pooling of interests method of accounting uses the carrying amounts of items recognized in the financial statements. The carrying amount of the items in the statement of financial position will

¹⁹ The IASB’s amended definition of fair value is “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date,” IFRS 13, *Fair Value Measurement*, Appendix A. Paragraph B2 sets out the objective of a fair value measurement which “is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions.”

generally reflect different measurement bases because, for example, the entity (1) has some items that are required to be held at fair value and other items that are required to be held at cost or (2) has chosen options available under IPSASs to hold certain items at fair value and 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, this CP refers to it as a “measurement approach.”

- 3.17 The advocates of the use of carrying amount consider it satisfies the qualitative characteristics of relevance and faithful representation because it reflects the amounts recognized in the financial statements of the combining entities before the uniting of interests took place. Thus, the subsequent performance of the combined entity, i.e., its accountability for the management of those resources, may be assessed on the same basis as that was used to assess accountability before the uniting of interests. It also allows users to better assess trends and directions related to the performance of the combined entity. Therefore, the use of carrying amount in the pooling of interests method of accounting, is seen as satisfying users’ needs because the information provided by the carrying amount provides continuity of the values of the net assets of the combining entities into the combined entity.
- 3.18 In addition, carrying amount also satisfies the qualitative characteristic of comparability because it retains the values of the recognized assets and liabilities in the combining entities from before the uniting of interests. The performance of the combined entity and the combining entities can then be compared without adjusting for a change in measurement basis, except for any alignment of accounting policies.
- 3.19 Carrying amount is usually easily verifiable because the accounting records of the combining entities are readily available and can provide confirmation of amounts to the combined entity.
- 3.20 Those that advocate use of the pooling of interests method consider that it is almost always the least costly method to apply as it uses the existing carrying amounts of the assets, liabilities and equity of the combining entities and does not require identifying, measuring and recognizing assets or liabilities not previously recognized before the uniting of interests.

The Fresh Start Method

- 3.21 The premise of the fresh start method is that the resulting entity is a new entity (irrespective of whether a new entity is formed) and therefore its history commences on that date. The fresh start method requires all of the identifiable assets and liabilities of all the combining entities to be measured at fair value as at the date of the combination. This includes the recognition of identifiable assets and liabilities that were not previously recognized by the combining operations. For example, using Entities A and B from paragraph 3.14 above, i.e., Entity A has recognized net assets of CU50 and Entity B has recognized net assets of CU40. However, the fair values of the identifiable recognized and unrecognized net assets are: CU70 for Entity A and CU80 for Entity B. The resulting entity recognizes net assets of CU150.
- 3.22 The fresh start method has been suggested as a replacement for the pooling of interests method by those who consider that business combinations where no acquirer can be identified should be distinguished from an acquisition and have a different accounting treatment. They consider that the fresh start method is conceptually superior to the pooling of interests method because (1) the resulting entity is held accountable for the current value of the resources acquired from the combining operations and (2) it provides more complete information of the transaction or other

event because it recognizes the identifiable assets and liabilities of the combining operations regardless of whether they were recognized prior to the transaction.

- 3.23 In addition, those who support the fresh start method consider that this method is, to a large extent, an extension of the use of fair value in the acquisition method of accounting for business combinations. As a result, many of the issues that may arise regarding the recognition and measurement of items have already been addressed. The fact that the acquisition method has been applied for many years means that that experience should overcome most concerns about the faithful representation of the information produced by the use of the fresh start method.
- 3.24 Those who support the use of the fresh start method acknowledge that this approach would need to be further developed before it could be applied in practice. However, they consider most of the issues could be resolved by extending the guidance already available on the application of the acquisition method and thus would not be onerous.

Summary

- 3.25 Table 5 below summaries the three methods of accounting.

Table 5: Summary of Methods of Accounting

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

4 The Boundary between Acquisitions and Amalgamations

- 4.1 The determination of whether a PSC is an acquisition or an amalgamation is based on the definitions of acquisition and amalgamation. Section 2 defines these terms as:

“An **acquisition** is a transaction or other event where a recipient gains control of one or more operations.”

“An **amalgamation** is a transaction or other event where two or more operations combine and none of the combining operations gain control of the other operations.”

- 4.2 The distinguishing feature of an acquisition is that an acquirer gains control. It follows that the distinguishing feature of an amalgamation should also be based on how control of the combining operations' change. An amalgamation is distinguished by the fact that none of the combining entities gain control of the other operations. Thus, to determine whether a PSC is an amalgamation, the sole definitive criterion for identifying an amalgamation is that none of the combining operations gain control of the other operations.
- 4.3 When in place, IAS 22 required the fair values of the combining entities be relatively equal. This is due to the fact that if the combining entities are of a disparate size, an acquirer could be identified, i.e., usually the larger of the combining entities. Does this reasoning apply in the public sector? Where an amalgamation is directed by a higher level of government say, by the enactment of legislation because it does not control the lower level of government, it would seem that the relative size of the combining entities has little to do with the actions or intent of the combining entities and thus such a factor is unlikely to be relevant in identifying an acquirer.
- 4.4 IAS 22 required that before a business combination could be classified as a uniting of interests that an overriding criterion and three essential characteristics had to be met. The view in this CP is that the meeting of an overriding criterion is essential before a PSC can be classified as an amalgamation, but requiring other essential characteristics to be met in addition is not necessary. However, this does not imply that other characteristics are completely ignored. Instead, they could be used to help in determining whether the definition of an amalgamation is met.
- 4.5 One characteristic that could be relevant in determining whether a PSC is an acquisition or an amalgamation is the transfer of consideration. In acquisitions, consideration is usually transferred (an amount paid in cash or other assets) to reimburse the former owners of an entity for their loss of control of that entity. A lack of consideration may indicate that there is no acquirer. However, many acquisitions in the public sector also occur without the transfer of consideration. So this characteristic could only be used as one of the relevant factors to consider in determining whether a PSC meets the definition of an acquisition or an amalgamation.
- 4.6 Other characteristics that could be considered to be relevant when making this determination include:
- (a) Whether the PSC is directed by a higher level of government – if it is directed, this indicates that it could be an amalgamation;
 - (b) Whether one of the combining operations' to a PSC dominates – if one of the combining operations dominates, this indicates that it could be an acquisition; and

- (c) Whether one of the combining operations' appoints significantly more of the governing board of the resulting entity – if one of the combining operations appoints significantly more of the governing board of the resulting entity, this indicates that it could be an acquisition.
- 4.7 The characteristics present in a specific PSC can be used in helping to determine whether it meets the definition of an acquisition or an amalgamation. For the majority of PSCs this will be immediately clear, but for a small minority, professional judgment will be necessary.

5 Accounting for Public Sector Combinations not under Common Control (PSCs NUCC): Acquisitions

Introduction

- 5.1 An acquisition takes place between entities NUCC where a recipient gains control of one or more operations. The purpose of most types of acquisitions undertaken in the public sector relates to improving the efficiency and effectiveness of the delivery of goods and services for community or social benefit, rather than to improve the return on investment to the owners of that entity. An acquisition may occur as a result of the reallocation of responsibilities between different levels of government (e.g., federal and provincial) or as a result of a decision taken by government to acquire a private sector entity.
- 5.2 This section of the CP focuses solely on acquisitions of operations that are NUCC. Acquisitions of operations UCC are discussed in Section 7.

What is the Appropriate Method of Accounting?

- 5.3 Section 3 explains the acquisition method of accounting as it is applied in IFRS 3 for business combinations by profit-oriented entities.
- 5.4 In the public sector, an acquisition occurs where a recipient gains control of one or more operations. The IPSASB considers that the acquisition method is the appropriate method of accounting to apply to an acquisition in the public sector in so far as it requires the recipient to recognize in its financial statements, the assets acquired and the liabilities assumed in one or more newly controlled operations, less minority interests (if any). The reason for this is that it is generally consistent with the recognition requirements for acquisitions of assets or the assumption of liabilities in IPSASs. Thus, it enhances comparability between acquisitions of operations and acquisitions of other types of assets.
- 5.5 However, the IPSASB has not reached a conclusion as to whether the use of fair value as the measurement basis to apply in the acquisition method is appropriate for some or all acquisitions in the public sector. This is because the most prevalent type of acquisitions are where operations are acquired for the achievement of objectives relating to the delivery of goods and services for community or social benefit, rather than to generate profits. Additionally, many acquisitions do not include the transfer of consideration. Some consider that these types of acquisitions are different in nature from business combinations as identified in IFRS 3 because the concept of acquiring an operation directly in exchange for the transfer of consideration is missing.
- 5.6 This difference between acquisitions in the public sector and business combinations as identified in IFRS 3 led the IPSASB to consider that the requirements in IFRS 3 could be appropriate for a circumscribed set of transactions or other events that are similar in nature to business combinations. Whilst these types of acquisitions are rare in the public sector, they do occur.

Exchange Transactions and Non-exchange Transactions

- 5.7 At the commencement of this project, the IPSASB proposed that a distinction be made between acquisitions arising from exchange transactions and acquisitions arising from non-exchange transactions. As already noted, the IPSASB based ED 41, *Entity Combinations from Exchange Transactions* on IFRS 3. However, IFRS 3 includes requirements related to bargain purchases and

the IPSASB was concerned that acquisitions arising from exchange transactions could not be clearly distinguished from acquisitions arising from non-exchange transactions. Some did observe that, at the margin, it may be difficult to distinguish between an exchange transaction involving a discount (bargain purchase) and a non-exchange transaction. However, it was noted that such discount exchange transactions (in particular, deep discounts) may be relatively rare in practice, and the consequences of a mis-allocation could not be determined until the IPSASB had agreed the treatment for a non-exchange acquisition.

What is the Appropriate Measurement Basis or Approach?

- 5.8 This section explores whether different types of acquisitions should be distinguished and whether the acquisition method as set out in IFRS 3 should be applied to all acquisitions or modified for application to some acquisitions, as follows:
- (a) Fair value as the measurement basis for all acquisitions; or
 - (b) Distinguish between different types of acquisitions so that:
 - (i) Carrying amount is used as the measurement approach for acquisitions where no consideration is transferred (public sector-type acquisitions); and
 - (ii) Fair value is used as the measurement basis for acquisitions where consideration is transferred (IFRS 3-type acquisitions).
- 5.9 Some are of the view that the fair value approach achieves the objectives of financial reporting and provides more useful information to users than other bases that may be adopted. However, others argue that using carrying amount also achieves the objectives of financial reporting and is less costly to implement than applying fair value. This view is consistent with IPSASs, as entities could then revalue to fair value subsequent to initial recognition if such an approach provided more information to users for those entities that use predominately historical cost amounts. The arguments for these views are explored further below.

Use of Fair Value as the Measurement Basis for all Acquisitions

- 5.10 When applying the acquisition method, those that advocate adoption of fair value as the measurement basis for the identifiable assets acquired and liabilities assumed in a newly controlled operation consider it satisfies users' needs for information for accountability and decision-making purposes. This is because it enables users to better assess the initial investment made by the recipient where consideration is transferred because a comparison can be made between the value of the consideration transferred and the value of net assets acquired in the newly controlled operation.
- 5.11 The use of fair value also enables users to better assess the value of all the assets and liabilities that the recipient gains control of, has an obligation to be accountable for, and to use efficiently and effectively in achieving its service delivery and other objectives.
- 5.12 The application of fair value is consistent with the measurement basis adopted when acquiring assets or incurring liabilities individually because:

- (a) The cost of acquiring assets (or incurring liabilities) individually reflects fair value²⁰ at the date of acquisition in an exchange transaction; and
 - (b) If the transaction to acquire an individual asset is a non-exchange transaction, IPSASs require the asset to be recognized and initially measured at fair value at the date of acquisition.
- 5.13 Therefore, using fair value enhances comparability²¹ between acquisitions of individual assets and acquisitions of operations that have similar assets because the measurement method is the same irrespective of the means by which those assets and liabilities are obtained.
- 5.14 Those that advocate the adoption of fair value as the measurement basis in applying the acquisition method of accounting to PSCs consider that fair value meets the qualitative characteristic of relevance.²² This is because the recipient recognizes, and will be held accountable for, the current value of the resources it gains control of, and information about the current value of those resources, and changes in them in subsequent periods, is useful input for accountability and decision-making purposes. Fair value provides more relevant information to users than carrying amount irrespective of whether the recipient acquires a profit-oriented or not-for-profit oriented newly controlled operation because:
- (a) Where a recipient acquires a profit-oriented newly controlled operation, the use of fair value provides current information about the expected future cash flows that the newly controlled operation is expected to generate which enhances the predictive value of information; and
 - (b) Where a recipient acquires a not-for-profit-oriented newly controlled operation, the use of fair value provides the current value of the assets that undertake service delivery activities which enhances the confirmatory value of information.
- 5.15 In addition, using fair value provides a faithful representation²³ of the consequences of an acquisition because it requires the recipient to recognize in its financial statements the identifiable assets acquired and liabilities assumed, including those not previously recognized by the newly controlled operation before the acquisition.

²⁰ Note that the cost or consideration transferred (if any) by the recipient to the transferor in an acquisition does not usually equal either the fair value or the carrying amount of the net assets acquired.

²¹ Paragraph 3.21 of CF–ED1 describes the qualitative characteristic of comparability as:
“Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena. Comparability is not a quality of an individual item of information, but rather a quality of the relationship between two or more items of information.”

²² Paragraph 3.6 of CF–ED1 describes the qualitative characteristic of relevance as:
“Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. Financial and non-financial information is capable of making a difference when it has confirmatory value, predictive value, or both. It may be capable of making a difference, and thus be relevant, even if some users choose not to take advantage of it or are already aware of it.”

²³ Paragraph 3.10 of CF–ED1 describes the qualitative characteristic of faithful representation as:
“To be useful in financial reporting, information must be a faithful representation of the economic and other phenomena that it purports to represent. Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error. Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance—which is not necessarily always the same as its legal form.”

- 5.16 Those that advocate the use of fair value as the measurement basis in applying the acquisition method of accounting, argue that it is able to satisfy the other qualitative characteristics of financial reporting and the constraints on information included in GPFRs. That is, the information would also need to be presented in a timely way, in a manner that is understandable and be verifiable. They acknowledge that in some cases:
- (a) It may be more costly to determine fair value than carrying amount, particularly where there is not a deep and liquid market for the assets, but note that IPSASs provide guidance on techniques that may be adopted for determining fair value in these circumstances; and
 - (b) It may be more difficult to verify fair value than carrying amount, but again note that in Phase 1 of its Conceptual Framework project, the IPSASB provides guidance on what verifiability may mean in these circumstances and that it also provides for a balance between the qualitative characteristics.
- 5.17 In the view of advocates of fair value, the greater relevance of information provided by fair value justifies a lower level of verifiability in some cases. They also accept that if indeed fair value cannot be determined in such a way that it satisfies the qualitative characteristics, another measurement basis or bases will need to be adopted.

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

- 5.18 There are those of the view that the use of fair value as a measurement basis for all acquisitions NUCC in the public sector is not appropriate because the purpose and nature of the majority of acquisitions is different to that of profit-oriented entities.
- 5.19 Generally, the purpose of an acquisition NUCC in the public sector is to improve the efficiency and effectiveness of an entity's service delivery and other objectives, rather than to generate profits. The structure of public sector entities is usually different to that of profit-oriented entities in that public sector entities do not usually have ownership instruments with investors wanting to maximize their returns. Thus, when an acquisition transaction or other event is being negotiated, the question of the transferor receiving adequate compensation for losing control to the recipient of the newly controlled operation does not arise. In other words, there is usually no transfer of consideration.
- 5.20 For acquisitions NUCC that involve the transfer of no consideration and net assets are acquired, the recipient effectively receives a gift or contribution from the transferor. Albeit that some contributions may be involuntary when the acquisition is directed. Where a recipient assumes net liabilities, the recipient gives a gift or contribution to the transferor. And again, that contribution may be involuntary when the acquisition is directed.
- 5.21 In addition, the objectives of GPFRs, the users of GPFRs and their information needs differ between profit-oriented entities and public sector entities. Paragraph 3.6 summarizes the objectives of GPFR, the users of GPFRs and their information needs, for profit-oriented entities that apply the IASB's standards. CF-ED1 sets out the objectives of GPFR, the users of GPFRs and their information needs, for public sector entities that apply accrual IPSASs. The objectives of GPFR by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and decision-making purposes. The users of GPFRs are service recipients and resource providers. For accountability and decision-making purposes, users' need information such as: (1) whether the entity is using resources economically, efficiently, effectively and as intended, and whether such use is in their interests, (2) information about the

entity's anticipated future service delivery activities and objectives, and the amounts and sources of cost recoveries necessary to support those activities, (3) whether the entity is achieving the objectives established as the justification for the resources raised during the reporting period and (4) whether the entity is likely to need additional (or less) resources in the future, and the likely sources of those resources.

- 5.22 In summary, the differences between business combinations for profit-oriented entities and the majority of acquisitions NUCC for public sector entities set out above, relate to (1) the nature and purpose of acquisitions NUCC, (2) the objectives of financial reporting and (3) the users of this information and their information needs. These differences mean that the requirement in IFRS 3 to apply fair value measurement may not be relevant.
- 5.23 Users of public sector entities' financial statements are not assessing an acquisition NUCC for information about the markets expectation of the value of the future cash flows associated with the acquired net assets. Instead, users of public sector entities' financial statements are assessing whether the net assets acquired will help achieve the objectives of the entity and whether the entity will need additional (or less) resources to operate the net assets acquired. This information can be obtained by using carrying amount and therefore it is appropriate to depart from the measurement basis applied in IFRS 3.
- 5.24 Because of the differences discussed above, this CP explores a potential distinction between different types of acquisition. This potential distinction is based on whether (1) an acquisition includes the transfer of consideration or (2) an acquisition where no or nominal consideration is transferred. If this distinction is considered to be operational, then the application of fair value or carrying amount as the measurement basis or approach by a recipient for a newly controlled operation could be determined using this distinction. If the acquisition method of accounting is applied using carrying amount it would need to be described as the "modified acquisition" method.
- 5.25 The previous paragraph used the term "no or nominal" consideration. The inclusion of the term "nominal" is to include acquisitions where a nominal amount is transferred. The transfer of a nominal amount of consideration may arise as part of the negotiation process in an acquisition. It may also be involuntary in nature, e.g., where nominal consideration is transferred to satisfy the requirements in legislation or other regulation that an acquisition must include a transfer of consideration. For the purpose of simplicity, "no or nominal consideration" will hereafter be referred to as "no consideration."
- 5.26 The distinction between "no consideration transferred" and "consideration transferred" is used as a proxy for public sector-type acquisitions and IFRS 3-type acquisitions, respectively. IFRS 3-type acquisitions may be somewhat rare but they do occur in practice, and therefore, a distinction between different types of acquisitions NUCC is required so that the appropriate accounting treatment can be applied.

Consideration Transferred

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

- 5.28 The determination of whether consideration is transferred relates to the substance of the transaction or other event in which the acquisition occurs. In some instances this may be a matter of judgment.

Acquisition does not involve the Transfer of Consideration

- 5.29 Where an acquisition does not involve the transfer of consideration, this type of acquisition is different in nature to an IFRS 3-type acquisition because the recipient acquires a newly controlled operation without compensating the transferor. This CP refers to this type of acquisition as a “public sector-type acquisition.” Because the economic circumstances are dissimilar to IFRS 3-type acquisitions, the net assets acquired should be recognized and measured at carrying amount. In other words, there are public sector specific reasons to depart from IFRS 3 in the measurement of the identifiable assets acquired and liabilities assumed.
- 5.30 Using carrying amount as a measurement approach in applying the acquisition method of accounting to acquisitions where no consideration is transferred satisfies users’ needs for accountability and decision-making purposes because the information provided by the carrying amount provides continuity of the values of the assets acquired and the liabilities assumed from before the acquisition.
- 5.31 Those that advocate the use of carrying amount consider it satisfies the qualitative characteristics of relevance and faithful representation because it reflects the amounts recognized in the financial statements of the newly controlled operation before it was acquired by the recipient. Thus, the subsequent performance of the recipient, i.e., its accountability for the management of these resources, can be assessed on the same basis as that used to assess accountability before the acquisition. It also allows users to better assess trends and directions related to the performance of the newly controlled operation.
- 5.32 Those that support this view consider a significant factor leading to decisions to undertake an acquisition without the transfer of consideration is the intent to reduce the cost of services through achievement of economies of scale or reduced administrative costs. Accordingly, initial recognition at the carrying amounts previously recognized by the pre-acquisition operations retains the same perspective on the reporting of those assets and liabilities.
- 5.33 One of the reasons cited for carrying amount being inappropriate relates to the view that carrying amount provides less relevant information than fair value because the recipient is not held accountable for the current value of the resources acquired. In other words, the initial investment made by the recipient. This is because if the recipient had to buy the assets individually rather than acquire them in an acquisition they would be accounted for at cost, which is assumed to equal fair value at the date of acquisition in an exchange transaction. However, this view is predicated on the fact that there is an initial investment by the recipient, i.e., there is a transfer of consideration. Thus, this view is not relevant to acquisitions NUCC that do not involve the transfer of consideration.

Treatment of the Difference Arising

- 5.34 Because of the differences identified in public sector-type acquisitions when compared with IFRS 3-type acquisitions, this section explores the possible accounting treatments of the difference arising

when no consideration is transferred. The difference arising is calculated as the difference between:

- (a) The net assets acquired or the net liabilities assumed; minus
- (b) The amount of any minority interest²⁴ in the newly controlled operation (if any).

Treatment of Difference Arising Where Recipient Acquires Net Assets

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

5.36 The IPSASB considered whether the gain should be accounted for as a direct increase to net assets/equity or as revenue. IPSAS 1, *Presentation of Financial Statements* defines net assets/equity as the residual interest in the assets of the entity after deducting all its liabilities. IPSAS 1 envisages four components of net assets/equity. Those components include:

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

5.37 The nature of a gain is compared to the definitions of the components of net assets/equity identified in paragraph 5.36:

- (a) Contributions from owners are defined as “future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which: (a) Conveys entitlement both to (i) distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to (ii) distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or (b) Can be sold, exchanged, transferred, or redeemed.” A gain does not meet this definition because the transferor has not made a contribution to the recipient that results in a financial interest in the entity by the transferor as envisaged by IPSAS 1.
- (b) Accumulated surplus/deficit is an accumulation of an entity’s surpluses and deficits. A gain represents an individual transaction or other event and not an accumulation.
- (c) Reserves generally arise from items recognized directly in net assets/equity from specific requirements in IPSASs, and may include, for example, gains and losses on revaluation of

²⁴ The accounting treatment of a minority interest is considered later in this section.

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

- (d) A minority interest is defined as “that portion of the surplus or deficit and net assets/equity of a controlled entity attributable to net assets/equity interests that are not owned, directly or indirectly, through controlled entities, by the controlling entity.” A gain does not meet this definition, although an acquisition may involve minority interests.

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

5.39 Revenue is defined as:

“The gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.” (IPSAS 1)

5.40 The gain in an acquisition NUCC is an inflow of economic benefits or service potential during the reporting period because the recipient has acquired net assets from the transferor. It is not a “gross” inflow because net assets acquired is a net amount hence the term “gain” is used rather than “revenue.”²⁵ The inflow results in an increase in net assets/equity of the recipient and does not meet the definition of a contribution from owners. Therefore, a gain meets the definition of revenue and should be recognized in surplus or deficit (in the statement of financial performance) in the reporting period in which it occurs. Because a gain meets the definition of revenue it should not be recognized directly in net assets/equity.

5.41 The IPSASB considers that the treatment of a gain is consistent with the requirement in IPSAS 23 that an inflow of resources from a non-exchange transaction is recognized as revenue.²⁶

5.42 This treatment of the difference arising as a gain is also consistent with the requirement in IFRS 3 with the treatment of a gain arising from a bargain purchase although the approach taken to arrive at the same accounting treatment differs. This is because IFRS 3 views a bargain purchase as an anomaly in that “business entities and their owners generally do not knowingly and willingly sell assets or businesses at prices below their fair values,”²⁷ and as such occur only rarely. Furthermore, the calculation of a bargain purchase involves consideration transferred, i.e., if the fair value of the acquirer’s share of the acquired identifiable assets and liabilities exceeds the consideration transferred, the acquirer recognizes a bargain purchase.

²⁵ This parallels the treatment of the disposal of property, plant, and equipment in IPSAS 17, *Property, Plant, and Equipment* where the gain or loss arising from the derecognition of an item of property, plant, and equipment shall be included in surplus or deficit when the item is derecognized (IPSAS 17.83).

²⁶ IPSAS 23, paragraph 44.

²⁷ IFRS 3, Basis for Conclusions paragraph BC371.

Treatment of Difference Arising Where Recipient Assumes Net Liabilities

- 5.43 Where the recipient assumes net liabilities, the difference arising will result in a decrease in net assets/equity in the financial statements of the recipient. In other words, the recipient has assumed an economic loss by the acquisition of an operation from the transferor. Similar to the reasoning used above for the recognition of a gain, the decrease in net assets/equity should be recognized as a loss in surplus or deficit (in the statement of financial performance) in the reporting period in which it occurs. This information is relevant to users as it reflects the effect of this transaction or other event on the recipient.
- 5.44 This treatment of the difference arising as a loss is different from the requirements in IFRS 3. IFRS 3 determines that the residual between the excess of the aggregate of consideration transferred and the amount of non-controlling interests (if any), and the acquisition date amounts of the fair value of the acquiree's net identifiable assets and liabilities, meets the definition of an asset, called goodwill, and is recognized in the statement of financial position.
- 5.45 In the same way as modifying the acquisition method for the measurement approach used for a public sector-type acquisition, if the difference arising is treated as either a gain or a loss, as appropriate, the method of accounting would need to be described as the "modified acquisition" method.

Acquisition involves the Transfer of Consideration

- 5.46 Where an acquisition involves the transfer of consideration, this type of acquisition is viewed as being similar in nature to business combinations within the scope of IFRS 3 because the recipient acquires a newly controlled operation directly in exchange for the transfer of consideration to the transferor. This CP refers to this type of acquisition as an "IFRS 3-type acquisition." The logic behind this is that, because the economic circumstances are similar, the accounting requirements should be similar to those in IFRS 3, i.e., recognize and measure identifiable assets acquired and liabilities assumed at fair value (with some limited exceptions). Goodwill is measured indirectly as the excess of the aggregate of consideration transferred and the amount of non-controlling interests (if any), and the acquisition date amounts of the fair value of the acquiree's net identifiable assets and liabilities. 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. In other words, there is no public sector specific reason to depart from IFRS 3 in applying the acquisition method of accounting.

Summary of Potential Distinction between Acquisitions based on whether or not Consideration is Transferred

- 5.47 Table 6 below summarizes the potential distinction between acquisitions NUCC.

Table 6: Potential Distinction between Acquisitions NUCC

	No Consideration Transferred		Consideration Transferred	
Described as	Public sector-type acquisition		IFRS 3-type acquisition	
Measurement Basis	No remeasurement, the assets and liabilities recognized in the newly controlled operation's statement of financial position are recognized by the recipient at carrying amount		Remeasures the newly controlled operation's identifiable assets and liabilities to fair value	
Treatment of Difference Arising	Recipient acquires net assets	Gain	Consideration transferred in excess of net assets acquired	Goodwill
	Recipient assumes net liabilities	Loss	Net assets acquired in excess of consideration transferred	Gain from bargain purchase

Other Issues

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

- (a) The presence of minority interests; and
- (b) Acquisition-related costs.

Presence of Minority Interests

5.49 The discussion above does not consider an acquisition where less than 100% of the ownership instruments are obtained by the recipient. This section of the CP considers situations where a recipient gains control of less than 100% of the newly controlled operation. The portion that does not relate to the controlling entity is termed a "minority interest." A minority interest is defined as:

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

Measurement of a Minority Interest

5.50 A minority interest can be measured at either:

- (a) Fair value; or
- (b) The minority interest's proportionate share of the newly controlled operation's net assets.²⁸

²⁸ The accounting treatment of minority interests is based upon the requirements for non-controlling interests in IFRS 3 and that Standard gives acquirers' an option of measurement bases to choose from. The IPSASB uses the term "minority interest."

- 5.51 Where a newly controlled operation is listed on a stock exchange, fair value will be based on active market prices for the equity shares not held by the recipient. Where it is not listed, fair value will need to be estimated using a valuation technique.
- 5.52 Many acquisitions NUCC in the public sector do not involve the transfer of consideration, and, except in rare circumstances, a newly controlled operation will not be listed on a stock exchange. Thus, fair value would need to be estimated.

Potential Preliminary View:

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

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

Effect of a Minority Interest on the Difference Arising

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

Acquisition-Related Costs

- 5.54 Acquisition-related costs are the costs a recipient incurs to effect the acquisition. Examples of acquisition-related costs include legal, accounting valuation and other professional and consulting fees, and costs to issue debt or equity securities.
- 5.55 Existing IPSASs for non-financial assets use a cost accumulation approach for the measurement on initial recognition of an asset from an exchange transaction. Therefore, the initial cost of an asset is its purchase price, plus any directly attributable costs.²⁹ The measurement on initial recognition of an asset from a non-exchange transaction is fair value at the date of acquisition.
- 5.56 Existing IPSASs for financial assets require the measurement on initial recognition at fair value, plus, in the case of a financial asset not at fair value through surplus or deficit, transaction costs that are directly attributable to the acquisition of the financial asset.
- 5.57 One view is that acquisition-related costs are not part of the cost of acquisition of the newly controlled entity or operation because they are not transactions between the recipient and transferor. Rather they are transactions between the recipient and other third-parties for services received. These costs are not assets at the date of acquisition because the benefits have already flowed to the recipient from the services received. Those of this view consider acquisition-related costs should be an expense in the statement of financial performance in the period in which the services are received. Where costs are directly related to the issue of debt or equity instruments

²⁹ Investment property (IPSAS 16.28), property, plant, and equipment (IPSAS 17.30), and intangible assets (IPSAS 31.34).

they should be recognized in accordance with IPSAS 29, *Financial Instruments: Recognition and Measurement*.

- 5.58 This view is similar to that applied in IFRS 3, which requires that the costs incurred by an acquirer to effect a business combination be accounted for as expenses in the period in which the costs are incurred and services are received except for the costs related to the issue of debt or equity securities which are accounted for in accordance with IAS 32, *Financial Instruments: Presentation* and IAS 39, *Financial Instruments: Recognition and Measurement*.³⁰
- 5.59 Another view is that acquisition-related costs meet the definition of an asset because they are directly attributable to the acquisition of the newly controlled operation. That the cost basis is not used for the measurement basis for the newly controlled operation's assets and liabilities is not relevant. Rather what is relevant is that future economic benefits or service potential are expected to flow to the recipient from its acquisition of the newly controlled operation. Those of this view consider acquisition-related costs should be recognized as an asset in the statement of financial position.
- 5.60 The IPSASB supports the former view that acquisition-related costs are not part of the cost of acquisition of the newly controlled entity or operation because they are not transactions between the recipient and transferor and should be an expense in the statement of financial performance in the period in which the services are received.

Potential Preliminary View:

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

³⁰ IFRS 3, paragraph 53.

6. Accounting for Public Sector Combinations not under Common Control (PSCs NUCC): Amalgamations

Introduction

- 6.1 An amalgamation takes place between operations NUCC where two or more operations agree to combine and none of the combining operations gain control over the other operations. In other words, no acquirer can be identified. In addition, the combining operations are unrelated parties.
- 6.2 The structure of an amalgamation can differ dependent on factors specific to each amalgamation, e.g., legislative requirements. An amalgamation may involve the formation of a new entity to be the resulting entity that receives the assets, liabilities and net assets/equity of the combining operations. Alternatively, an amalgamation may not involve the use of a new entity as the resulting entity and instead uses one of the combining operations as the resulting entity. This decision is a matter of the form of an amalgamation rather than the substance.
- 6.3 An amalgamation may be imposed by a higher level of government to be a cost-effective and efficient provision of public services even though, for financial reporting purposes, the higher level of government does not control the lower level of government. However, the higher level of government does have a regulatory role that enables it to direct a lower level of government into participating in an amalgamation. An amalgamation may also be undertaken voluntarily e.g., so that the combining operations are able to maintain the current level of services.

What is the Appropriate Method of Accounting?

- 6.4 Section 3 of this CP sets out two methods of accounting for amalgamations. They are: the pooling of interests method and the fresh start method. The use of carrying amount or fair value as a measurement approach or basis, respectively, are not separately discussed because the pooling of interests method uses carrying amount and the fresh start method uses fair value.

Application of the Pooling of Interests Method of Accounting

- 6.5 Under the pooling of interests method of accounting, the assets, liabilities and net assets/equity of the combining operations for the period in which the combination occurs and for any comparative periods disclosed, are included in the financial statements of the resulting entity as if they had been combined from the beginning of the earliest period presented. The resulting entity recognizes the assets, liabilities and net assets/equity of the combining operations at their existing carrying amounts, adjusted only as a result of aligning the combining operations' accounting policies and applying those policies to all periods presented.

Possible Modification to the Pooling of Interests Method

- 6.6 One of the requirements of the pooling of interests method is that comparative information is restated as if the combining operations had always been combined. One view of this requirement is that this information is clearly hypothetical and portrays a situation that did not actually exist. Those who agree with this view consider that the pooling of interests method could be modified to omit this requirement and instead, require the resulting entity to combine the items in the statement of financial position as at the date of the amalgamation. The surplus or deficit would then commence from the date of the amalgamation. Those of this view consider this to be

representationally faithful because the combining operations clearly did exist separately before the amalgamation. This would result in no comparatives being presented at the first reporting date. The surplus or deficit for the first reporting period would reflect only the performance of the resulting entity.

- 6.7 Those who consider that comparative information should not be restated acknowledge that the history of the combining operations helps in assessing the performance of the resulting entity. They consider that one method to ensure users can easily access this information is to require the presentation of “pro-forma” information on the combining operations’ statements of financial performance before the amalgamation so that users can easily compare the financial performance of the resulting entity against that of the combining operations.
- 6.8 Where the pooling of interests method includes this modification to account for the amalgamation at the date of the amalgamation rather than as if the entities had always been combined, this CP refers to it as the “modified pooling of interests” method.

Application of the Fresh Start Method of Accounting

- 6.9 Under the fresh start method of accounting, the resulting entity is considered to be a new entity and recognizes all identifiable assets and liabilities at fair value as at the date of the combination and therefore its history commences on that date.

Analysis

- 6.10 The IPSASB notes that the future cash flows and service potential of the resulting entity will generally be the same regardless of which method is used to account for the amalgamation. However, the financial performance of the resulting entity varies significantly depending on the method applied. If preparers are given a free choice of method this would reduce comparability between entities and over time.
- 6.11 In summary, the differences between business combinations for profit-oriented entities and some acquisitions NUCC for public sector entities, set out above relating to (1) the nature and purpose of acquisitions NUCC, (2) the objectives of financial reporting and (3) the users of this information and their information needs, mean that the requirement in IFRS 3 to apply fair value measurement may not be relevant.
- 6.12 Users of public sector entities’ financial statements are not assessing an acquisition NUCC for information about the markets expectation of the value of the future cash flows associated with the acquired net assets. Instead, users of public sector entities’ financial statements are assessing whether the net assets acquired will help achieve the objectives of the entity and whether the entity will need additional (or less) resources to operate the net assets acquired. This information can be obtained by using carrying amount and therefore it is appropriate to depart from the accounting requirements in IFRS 3.
- 6.13 Similar to public sector-type acquisitions NUCC, the purpose of most amalgamations NUCC are focused on the furtherance of objectives relating to the delivery of goods and services for community or social benefit, rather than to generate profits. In addition, combining operations do not usually have ownership instruments in the same way as profit-oriented entities so there is no exchange of ownership instruments to ensure that the relative risks and benefits of the resulting entity are maintained. The information needs of users are also similar to acquisitions NUCC.

- 6.14 These similarities mean that the reasoning for the use of carrying amount for public sector-type acquisitions NUCC can be applied to amalgamations NUCC. Therefore, the modified pooling of interests method is the appropriate method to apply to amalgamations NUCC. The IPSASB notes that IPSASs permit revaluation to fair value subsequent to initial recognition if a resulting entity considers that this approach would provide more information to users.

Potential Preliminary View:

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

An amalgamation NUCC should apply the modified pooling of interests method.

Accounting Treatment in the Combining Operations

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

Potential Preliminary View:

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

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

³¹ IPSAS 1, paragraph 38.

7. Accounting for Public Sector Combinations under Common Control (PSCs UCC): Acquisitions and Amalgamations

Introduction

- 7.1 Section 2 sets out the common features of a PSC UCC. It explains that the fundamental difference between a PSC UCC and a PSC NUCC is that the PSC UCC takes place between related parties. This has potential consequences on (1) whether the PSC benefits the parties to the PSC or other entities within the economic entity, (2) whether consideration is transferred and the amount of that consideration and (3) the other terms and conditions of a PSC. Acquisitions and amalgamations NUCC are discussed in Sections 5 and 6, respectively.
- 7.2 Although the related party aspect of a PSC UCC may affect the nature of the PSC, it can still meet the definition of an acquisition or amalgamation and this is discussed below.

Acquisitions UCC: Recipient Accounting

- 7.3 The definition of an acquisition is “a transaction or other event where a recipient gains control of one or more operations.” In an acquisition UCC, a recipient gains control of one or more operations, however, those operations are part of the same economic entity as the recipient. Therefore, it is a related party transaction.
- 7.4 This CP considers that the appropriate method of accounting for acquisitions NUCC is the acquisition method because it is generally consistent with the recognition requirements for acquisitions of assets or the assumption of liabilities in IPSASs. Section 5 on acquisitions NUCC proposes a split between public sector-type acquisitions and IFRS 3-type acquisitions.³² For public sector-type acquisitions it proposes to modify the acquisition method to use carrying amount instead of fair value, and to treat the difference arising as a gain or loss, as appropriate and consequently describes this method as the modified acquisition method).
- 7.5 The proxy used to potentially distinguish between different types of acquisitions NUCC is whether or not consideration is transferred. If no consideration is transferred, an acquisition NUCC is categorized as a public sector-type acquisition and where consideration is transferred it is categorized as an IFRS 3-type acquisition. However, this proxy does not appear to be operational for acquisitions UCC because the ultimate controlling entity can specify whether, and how much, consideration is transferred. The question is then: is the range of acquisitions UCC so broad as to require a distinction to put them into different categories? Because acquisitions UCC occur within an economic entity it is unlikely that there is the same broad range as for acquisitions NUCC and so no distinction is necessary.

What is the Appropriate Measurement Basis or Approach?

- 7.6 For acquisitions NUCC, paragraphs 5.19–5.23 sets out the differences between business combinations for profit-oriented entities and the majority of acquisitions NUCC for public sector entities. In summary the differences are: (1) the nature and purpose of acquisitions NUCC, (2) the objectives of financial reporting and (3) the users of this information and their information needs.

³² This section on acquisitions UCC may need to be revised depending on the decisions made relating to acquisitions NUCC.

Because of these differences the requirement in IFRS 3 to apply fair value measurement may not be relevant information for users of public sector entities' financial statements. That section concludes that users' information requirements can be met by using carrying amount. This reasoning also applies to acquisitions UCC.

Treatment of the Difference Arising

- 7.7 A key difference between acquisitions NUCC and acquisitions UCC is that acquisitions UCC are undertaken within an economic entity. The consequence of this is that an acquisition UCC may have an effect on the financial statements of the recipient and transferor, but it does not have an effect on consolidated financial statements of the ultimate controlling entity because the effects of this acquisition are eliminated in full.
- 7.8 The calculation of the difference arising may include consideration. This is because the transfer of consideration could be a result of the negotiation process for the acquisition UCC. The transfer of consideration could also occur because the ultimate controlling entity can specify whether, and how much, consideration is transferred. So the amount of the difference arising can be under the direct control of the ultimate controlling entity.
- 7.9 For acquisitions NUCC, paragraphs 5.34–5.45 explores the accounting treatment for a difference arising. This explanation also applies to acquisitions UCC. In summary, where a recipient acquires net assets, a gain should be recognized in surplus or deficit (in the statement of financial performance) and where a recipient assumes net liabilities, a loss should be recognized in surplus or deficit (in the statement of financial performance).

Acquisitions UCC: Transferor Accounting

Existing Requirements

- 7.10 This section is included in the CP because the accounting treatment for an acquisition UCC occurs within an economic entity and therefore the accounting requirements for the recipient and transferor should be consistent.
- 7.11 IPSAS 6 includes requirements where a controlling entity loses control of a controlled entity, irrespective of how control is lost. IPSAS 6 requires the inclusion of the revenue and expenses of that controlled entity in the consolidated financial statements until the date on which the controlling entity loses control of the controlled entity. IPSAS 6 also requires that the difference between the proceeds from disposal (if any) and the controlled entity's carrying amount at the date of disposal is recognized in the consolidated statement of financial performance as a gain or loss on disposal of a controlled entity.
- 7.12 IPSAS 6 also includes accounting requirements where a controlling entity retains an interest in the formerly controlled entity. IPSAS 6 requires that, from the date the controlled entity ceases to be a controlled entity, it is accounted for according to the relevant accounting standard dependent upon the type of interest retained. For example, where formerly controlled entity becomes an investment, IPSAS 29, *Financial Instruments: Recognition and Measurement* applies.
- 7.13 Where a single entity loses control of an operation, IPSASs include requirements for the derecognition of assets or the extinguishment of liabilities.

What is the Appropriate Measurement Basis or Approach?

- 7.14 The IPSASB considers that the appropriate measurement basis or approach for a transferor in an acquisition UCC is carrying amount because this is consistent with the requirements of IPSAS 6 and other IPSASs. In addition, this treatment is consistent with the measurement approach adopted by the recipient.

Treatment of the Difference Arising

- 7.15 IPSAS 6 requires that the difference between the proceeds from disposal (if any) and the controlled entity's carrying amount at the date of disposal is recognized in the statement of financial performance as a gain or loss on disposal of a controlled entity.^{33, 34} Similar requirements apply to the disposal of assets or the extinguishment of liabilities.
- 7.16 The IPSASB considers that the requirements in IPSAS 6 for the accounting treatment of the loss of control of a controlled entity and the requirements in other IPSASs relating to assets and liabilities are appropriate for the transferor in an acquisition UCC. In addition, this treatment is consistent with the treatment of the difference arising adopted by the recipient.

Amalgamations UCC: Resulting Entity Accounting

- 7.17 The definition of an amalgamation is "a transaction or other event where two or more operations combine and none of the combining operations gain control of the other operations." In an amalgamation UCC, two or more combining operations combine into a resulting entity and none of the combining operations gain control of the other operations. The difference between an amalgamation NUCC and UCC is that in an amalgamation UCC the combining operations are part of the same economic entity as the resulting entity. Therefore, it is a related party transaction.
- 7.18 In Section 6, the CP proposes that the resulting entity in an amalgamation NUCC applies the modified pooling of interests method. Paragraphs 6.11–6.14 set out the reasons for determining that this is the appropriate method of accounting to apply.
- 7.19 The IPSASB considers these factors also apply to amalgamations UCC. Therefore, the IPSASB considers that the resulting entity should apply the modified pooling of interests method of accounting.

Amalgamations UCC: Combining Operations Accounting

- 7.20 In Section 6, the CP proposes that the combining operations in an amalgamation NUCC continue to use the going concern basis in the preparation of their financial statements until the date of the amalgamation. Whilst an amalgamation UCC differs from an amalgamation NUCC in that it is a related party transaction, there are no reasons to differ in the conclusions drawn for amalgamations

³³ IPSAS 6, paragraph 51.

³⁴ IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* does not include requirements for the gain or loss arising from sale. Instead they are included in IAS 27, *Consolidated and Separate Financial Statements* paragraph 34(f) and are consistent with the requirements of IPSAS 6.

NUCC, that where the combining operations are still required to prepare financial statements, they are prepared on a going concern basis.

Appendix A: Examples of the Scope of this Consultation Paper

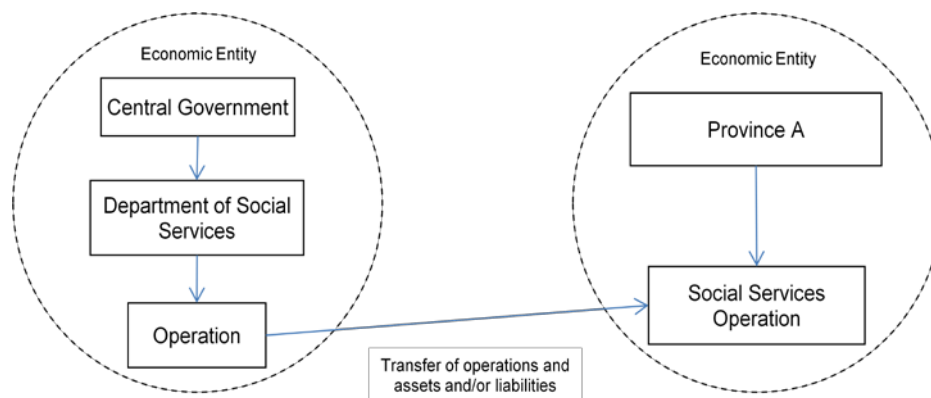
- A1. Set out below are examples of the types of transactions and other events that give rise to a PSC which are included in this CP.

PSC NUCC

Acquisition

- A2. Where the recipient and transferor are not part of the same economic entity, the PSC is NUCC. This CP includes in its scope the accounting treatment in the financial statements of the recipient, i.e., the entity that gains control of one or more operations.
- A3. An acquisition NUCC can be illustrated as follows.

Diagram 1: Acquisition NUCC

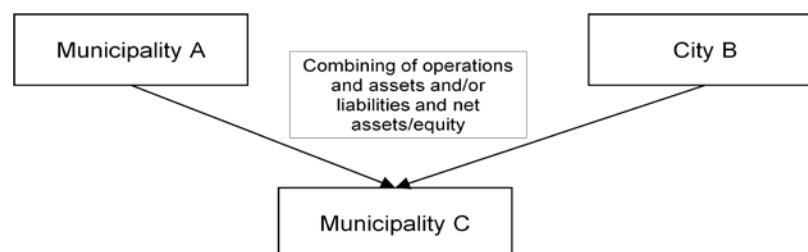


- A4. Diagram 1 illustrates a PSC between entities that are NUCC. The Department of Social Services within the Central government transfers an operation to Province A, which is not controlled by the Federal government. Province A is the recipient and the Department of Social Services is the transferor.

Amalgamation

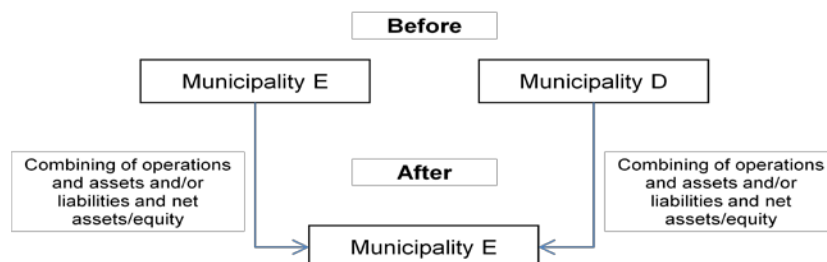
- A5. The transaction or other event that meets the definition of an amalgamation may take different forms and may or may not involve the formation of a new entity. These two situations can be illustrated as follows and assume that the local government is not under the control of the central or provincial government.

Diagram 2: Amalgamation NUCC using the Formation of New Entity



- A6. Diagram 2 above illustrates an amalgamation where Municipality C is formed to combine the operations, assets, liabilities and net assets/equity of Municipality A and City B. Municipality C is the resulting entity and Municipality A and City B are the combining operations. After the amalgamation, Municipality A and City B cease to exist.

Diagram 3: Amalgamation NUCC using an Existing Combining Operation



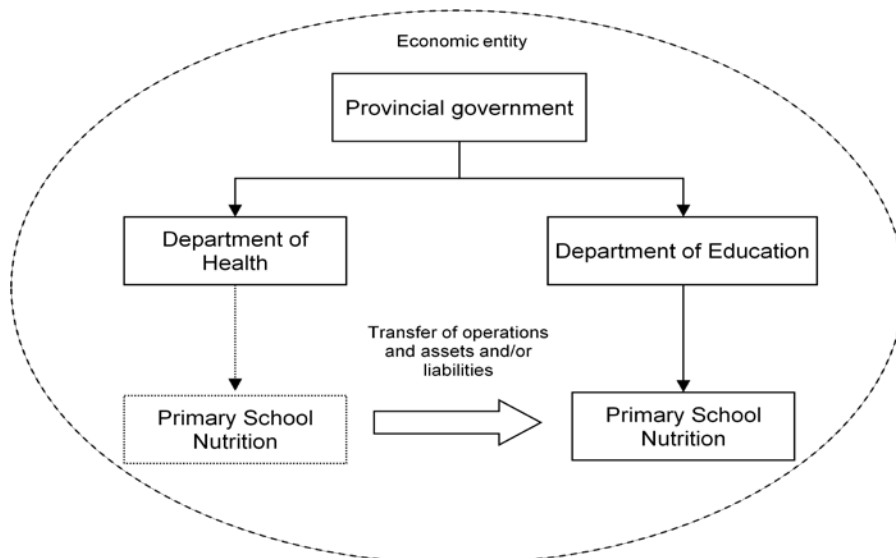
- A7. Diagram 3 above illustrates an amalgamation where Municipality D and Municipality E combine together and they use the entity that is Municipality E before the amalgamation to hold the assets, liabilities and net assets/equity of the amalgamation. This amalgamation was undertaken at the direction of the central government by the enactment of legislation because the central government in this jurisdiction does not control the local government. It was agreed that the name of the new municipality would be the same as one of the combining operations, so the resulting entity is named Municipality E. Municipality D and Municipality E before the amalgamation are the combining operations.

PSC UCC

Acquisition

- A8. Where the recipient and transferor are part of the same economic entity, the PSC is UCC. This CP includes in its scope the accounting treatment in the financial statements of the recipient and the transferor. This can be illustrated as follows.

Diagram 4: Acquisition UCC

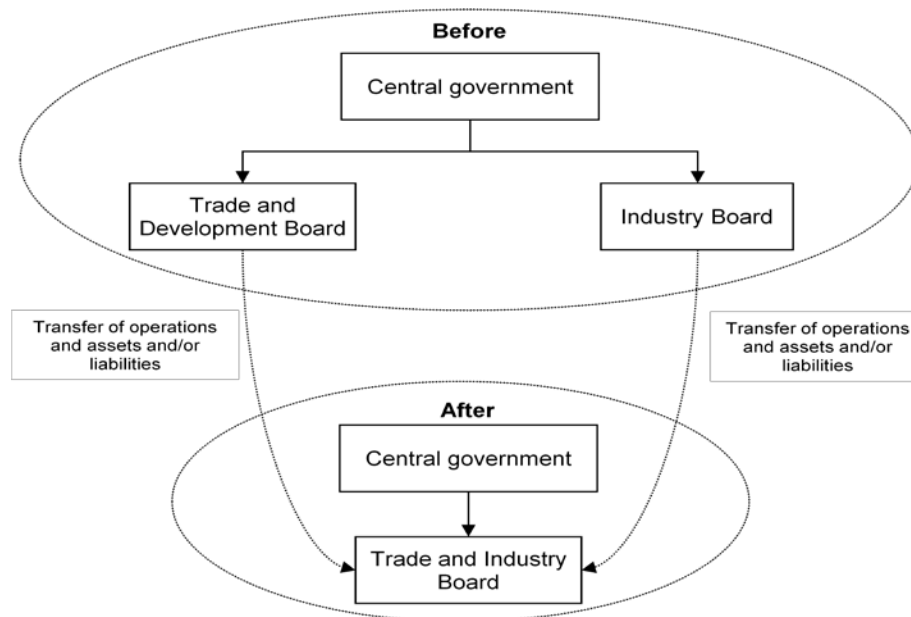


- A9. Diagram 4 illustrates an acquisition between entities that are UCC. The Department of Education gains control of the Primary School Nutrition operation from the Department of Health. The Department of Education is the recipient and the Department of Health is the transferor. Both departments prepare GPFSSs.

Amalgamation

- A10. An amalgamation may take place UCC as follows.

Diagram 5: An Amalgamation UCC



- A11. Diagram 5 illustrates an amalgamation where a Central government restructures by transferring the Trade and Development Board and the Industry Board, both of which are separate government operations and transferring the operations, assets and liabilities to a newly formed government entity, the Trade and Industry Board. The Trade and Development Board and the Industry Board are the combining operations and the Trade and Industry Board is the resulting entity. The Trade and Industry Board prepares GPFSSs.