Accounting Standards Board
P O Box 74129
Lynnwood Ridge
0040
Tel. 011 697 0660
Fax. 011 697 0666

Technical Director

International Public Sector Accounting Standards Board

International Federation of Accountants

277 Wellington Street, 4th floor

Toronto, Ontario M5V 3H2

Canada

14 August 2009

Dear Stephenie,

EXPOSURE DRAFT 41: ENTITY COMBINATIONS FROM EXCHANGE TRANSACTIONS

We enclose our response to your request for comment on Exposure Draft 41 – *Entity Combinations from Exchange Transactions* issued by the International Federation of Accountants – International Public Sector Accounting Standards Board (IPSASB).

In compiling our comment, the Accounting Standards Board, the official accounting standard setter for the public sector in South Africa, consulted widely with our stakeholders (comprising professional bodies, auditors and preparers) in formulating our comment to you.

While we support the development of an International Public Sector Accounting Standard on (IPSAS) *Entity Combinations from Exchange Transactions*, we do not envisage wide application of this IPSAS in the public sector.

Our response is structured into general matters and editorial amendments.

Please do not hesitate to contact me should you wish to discuss any of our comment.

Yours sincerely

Erna Swart

Chief Executive Officer

GENERAL

Illustrative Table

1. While we found the table illustrating the types of entity combinations undertaken by public sector entities useful, we question why the acquirer needs to be a "controlling entity". Controlling entity implies a parent-subsidiary relationship, but an entity combination does not always result in an entity acquiring control of another entity. For example, if an entity acquires an associate, it is also an entity combination but the acquirer does not become the controlled entity. And as the public sector entity can also be a non-controlling entity or an investor prior to the acquisition of the entity and only obtains control after the acquisition date, we propose the deletion of "controlling" in the first column headed "acquirer".

2. Furthermore, the GBE section could be expanded by adding "exchange and non-exchange" in the column "type of transaction" and "not under common control" in the column "common control".

Objective

3. The proposed IPSAS clarifies the difference between an exchange component and a bargain purchase. We propose that the difference between a non-exchange transaction and a bargain purchase should also be explained.

Scope

4. Even though paragraph .05 includes commentary to distinguish between the exchange and non-exchange component of an entity combination, we are of the view that it will be difficult in practice to apply the principle in distinguishing between such components.

5. Paragraph .05 states that the hierarchy in IPSAS 3 should be applied to determine the appropriate accounting treatment for the non-exchange component of the entity combination. As this should also be addressed in the proposed IPSAS to be developed for entity combinations arising from non-exchange transactions as referred in paragraph .04, we recommend that the reference to the hierarchy should be deleted. This recommendation is further supported by the fact that currently, there is no guidance that entities can consider for such combinations.

The Acquisition Method

Determining the acquisition date

6. Paragraph .14 currently includes an example of circumstances under which the acquirer obtains control on a date earlier than the closing date. We propose that a further example should be included, illustrating the circumstances under which the acquirer obtains control on a date after the closing date, as this is more likely to occur in the public sector.

Recognition conditions

7. Paragraph .19 that deals with the power to grant rights and the power to tax, is not included under the appropriate heading. We propose that the principle should rather be included as part of the section that deals with exceptions to the recognition and measurement principles (paragraphs .28 to .34).

8. We support the principle in paragraph .19, but highlight the fact that this paragraph is inconsistent with paragraph .77 in ED 40 *Intangible Assets*. Paragraph .77 in ED 40 requires that the power to grant rights and the power to tax should form part of the amount recognised as goodwill at the acquisition date.

Exception to the recognition principles

9. We question the exclusion of provisions and contingent liabilities from social benefits from the recognition principles as detailed in paragraph .30. If an entity has a social benefit obligation or contingent liability as defined in IPSAS 19, we are of the view that it should be taken into account in the recognition of indentifiable liabilities of the acquiree at acquisition date. If these obligations are not accounted for, it will result in the overstatement of goodwill recognised. We therefore recommend that the exclusion of provisions and contingent liabilities from social benefits should be re-considered. The same principles as those explained in paragraph .33 should apply to social benefits.

Exception to the measurement principles

10. We recommend that explanatory guidance should be included to explain “binding arrangement” as included in paragraph .36.

11. Paragraph .36 should be clarified to explain whether the power to grant rights and the power to tax should be considered as part of reacquired rights.

12. In the public sector, it is common for entities to operate as non-cash generating institutions. When a public sector entity acquires a cash-generating operation through an exchange transaction, the acquired combination may then form part of the entity’s non-cash-generating operations. Paragraph .38 highlights the fact that the subsequent measurement and accounting of goodwill is addressed in IPSAS 26, but it is not clear whether those principles should also be applied to the subsequent measurement and accounting of goodwill under the circumstances outlined above, i.e. when the combination is subsequently incorporated as part of the non-cash-generating activities. Currently IN12 explains that the impairment of non-cash-generating assets is dealt with in IPSAS 21, but no guidance is provided in IPSAS 21 or in the consequential amendments proposed to IPSAS 21 (see Appendix B) to explain the impairment of goodwill from non-cash-generating assets, or how goodwill should be impaired in the circumstances outlined above. We propose that the proposed IPSAS should

address these matters by clarifying the principles and explaining the reasoning thereof in the Basis for Conclusions.

An entity combination achieved by indirect acquisition

13. When comparing paragraph .49 with the equivalent IFRS 3, only IFRS 3.43(a) was included in the proposed IPSAS. The reason for excluding the principles in IFRS 3 .43(b) and (c) and IFRS 3.44 should be explained in the Basis for Conclusions and should be highlighted in the comparison with IFRS 3.

14. In addition, the terminology difference between “indirect transfer” in the proposed IPSAS (paragraph .49) and “without transferring consideration” in the IFRS 3 (paragraph 43) should also be explained in the Basis for Conclusions and could be highlighted in the comparison with IFRS 3.

Appendix A: Defined Terms

15. We propose that the phrase “other owner interests” should be included as part of the definition for “equity interests” to expand the definition to other capital contributing entities. This amendment will then be similar to the amendment included in paragraph .43.

16. We propose that the definition for “operation” be amended as follows:

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

Appendix B: Application Guidance

17. AG26 has been amended to refer to a “contractual-legal-binding criterion”. However, binding arrangement encompasses contractual and legal rights (as per IPSAS XX on *Intangible Assets* (ED 40)). We therefore propose that the reference “contractual-legal” should be deleted throughout the paragraph.

18. The example of a franchise agreement in AG29 is not applicable to the public sector. We recommend that a more appropriate public sector example should be included to explain the principle of a reacquired right.

19. AG32 includes the following statement “the acquirer will determine whether any goodwill recognized is impaired in accordance with IPSAS 21 *Impairment of Non-Cash-Generating Assets* and IPSAS 26 *Impairment of Cash-Generating Assets*”.

    However, no consequential amendments are proposed to IPSAS 21 with regards to the impairment of goodwill. The principle in paragraph .38 requires entities to allocate goodwill acquired in an entity combination to each of the acquirer’s cash-generating units or groups of cash-generating units that is expected to benefit from the synergies of the combination. IPSAS 21 does not acknowledge non-cash-generating units, and hence the principles proposed in IPSAS 26 could not be applied. We propose that the inconsistency between AG32, IN12 and paragraph .38 should be clarified. (Also refer to our comment on paragraph .38 above).

20. AG41 establishes the principles for the acquisition of a non-cash-generating operation. We are of the view that this principle should be included in the proposed IPSAS and not only in the application guidance. Furthermore, the Basis for Conclusions should summarise and explain the IPSASB's view and reasoning behind this principle.

21. AG51 inconsistently refers to "surplus", "earnings", "profit-sharing arrangement". We recommend that "earnings" should be used throughout the paragraph.

22. We question the deletion of the reference to IAS 12 in B63 in the equivalent IFRS 3. We propose that the reference to IAS 12, that prescribes the subsequent accounting for deferred tax assets and liabilities should be included as paragraph AG52(c), as income taxes are dealt with in paragraphs .31 and .32 of the proposed IPSAS.

23. AG53(g) refers to "goodwill" whereas AG41 refers to a "resulting expense". We recommend that consistent terminology should be used to describe the unallocated difference from the acquisition of a non-cash-generating operation.

Appendix C: Consequential amendments

IPSAS 6

24. When the IASB issued the revised IFRS 3 in 2008, amendments were also made to IAS 27 *Consolidated and Separate Financial Statements.* These amendments specifically relate to the accounting for non-controlling interests and the loss of control of a subsidiary. These amendments are however not incorporated as part of the consequential amendments to IPSAS 6, and we therefore recommend the inclusion of such principles as part of the amendments to IPSAS 6.

IPSAS 7

25. The consequential amendments to paragraphs .29 and .39 should also be clarified to consider circumstances where the public sector entity acquires a non-cash-generating associate, specifically with regards to the impairment of goodwill in such an acquisition.

IPSAS 21

26. We recommend that the example in the last sentence should be clarified as the purpose thereof is not clear.

IPSAS 26

27. Paragraph .90A(b) refers to an "operating segment" whereas IPSAS 18 distinguishes between "service and geographical" segments. The term "operating segment" should be aligned with the terminology in IPSAS 18.

28. The reference to “service potential” should be deleted in the example in paragraph .90B, as cash-generating assets are held for a commercial return and not for service delivery purposes.

29. The following bullet in the comparison with IAS 36 should be deleted:

 “Goodwill is outside the scope of IPSAS 26. IAS 36 includes extensive requirements and guidance on the impairment of goodwill, the allocation of goodwill to cash-generating units and testing cash-generating units with goodwill for impairment.”

Implementation Guidance

30. The example of the multifunctional manufacturing firm as included in IG51 (example 10) should be replaced with a more appropriate public sector example.

Basis for Conclusions

31. The Basis for Conclusions as currently drafted does not in all instances sufficiently explain the IPSASB’s views and reasoning behind the inclusion or exclusion of certain principles when compared to the equivalent IFRS 3. For example, BC6 explains the reason for the departure from the equivalent IFRS as being “for clarity”. We recommend that the Basis for Conclusions should in all instances clearly explain the reasoning and other public sector considerations that was taken into account in drafting the proposed IPSAS.

32. In addition, we also recommend that the Basis for Conclusions should explain the IPSASB’s conclusions reached with regards to the exception of the power to grant rights and the power to tax.

Illustrative Examples

Customer contracts and the related customer relationship

33. This example (IE11 to IE14) has been amended to refer to a “contractual-legal-binding criterion”. However, binding arrangement encompasses contractual and legal rights (as per IPSAS XX on *Intangible Assets* (ED 40)). We therefore propose that the phrases “contractual-legal” should be deleted.

Comparison

34. The following differences between the proposed IPSAS and IFRS 3 should also be highlighted in the comparison:

- Inclusion of additional commentary on the treatment of an entity combination that consists of an exchange and non-exchange component;
- The exclusion of a contingent liability arising from social benefits from non-exchange transactions as an exception to the recognition principles of contingent liabilities; and

- The treatment of the aggregate amount in the acquisition of a non-cash-generating operation.

Other Matters

35. The public sector terminology amendment from "equity" to "equity/net assets" has not been made consistently throughout the proposed IPSAS, for example paragraph IN10, and the definition of non-controlling interest in Appendix A. To ensure consistency with other IPSASs, "equity" should be changed to "equity/net assets" throughout the proposed IPSAS.

OTHER EDITORIAL AMENDMENTS

The following editorial amendments are proposed:

Reference	Current wording	Proposed amendment
Heading to IN5	Core principle	Amend "core principle" to "objective"
Par .03	"an entity that prepares…"	"an entity ~~that~~ which prepares…" (as per other IPSASs)
Par .04 last sentence	"…..this issue in a separate Standard"	"…..these issues in a separate Standard"
AG 46(b) second sentence	"….entered into for the purpose of providing future economic benefits to the acquirer…."	"….entered into for the purpose of providing future economic benefits or service potential to the acquirer…."
AG51(g) example	"….is determined in the basis of a multiple of surplus…"	"….is determined in the basis of a multiple of the entity's surplus…"
AG53(i)(ii)	"The gross contractual and non-contractual amounts receivable…"	"The gross contractual and non-contractual amounts receivable arising from binding arrangements…"
AG53(l)	"The total amount of goodwill that is expected to be deductible for tax purposes…"	"The total amount of goodwill that is expected to be deductible for tax purposes (where applicable)…"
AG56(d)	"…..(arising on the acquisition of cash-generating entities or operations…."	"…..(arising on the acquisition of cash-generating ~~entities or~~ operations…."
Consequential amendments to IPSAS 7 Par 29	"…of the investment and the investor's share of hte net fair value…"	"…of the investment and the investor's share of the ~~hte~~ net fair value…"

Reference	**Current wording**	**Proposed amendment**
Appendix D Example: Allocating an impairment loss (D5 to D9)	• Subsidiary • Parent • Profit of loss	Subsidiary should be amended to <u>controlled entity</u> Parent should be amended to <u>controlling entity</u> Profit or loss should be amended to <u>surplus or deficit</u>
Implementation Guidance IG 34 to IG 37	• Controlling entity • Controlled entity	• ~~C~~<u>c</u>ontrolling entity (lower case) • ~~C~~<u>c</u>ontrolled entity (lower case)
Illustrative examples IE 15(a)	Acquirer Company (AC) and Target Company (TC)	Acquirer <u>entity</u> ~~Company~~ (AC) and Target <u>entity</u> ~~Company~~ (TC) *(alternatively “acquirer entity” could be replaced with “acquirer” and “target entity” could be replaced with “acquiree”)*