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The Technical Director

International Public Sector Accounting Standards Board

International Federation of Accountants

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Per e-mail

30 October 2012

Dear Stephanie,

COMMENT ON THE CONSULTATION PAPER ON PUBLIC SECTOR COMBINATIONS

We support the development of guidance on the accounting treatment of public sector combinations in the general purpose financial statements of entities that use accrual based IPSASs. We believe that such guidance will provide consistent, comparable and useful information to users for accountability and decision-making purposes. We therefore welcome the opportunity to comment on the Consultation Paper on *Public Sector Combinations*.

Our comment to you is set out in three parts: Part I outlines comment to the preliminary views, Part II outlines comment to the specific matters for comment and Part III outlines other matters for consideration by the IPSASB.

The comment on the Consultation Paper is that of the Secretariat and not the Accounting Standards Board (Board). In formulating our comment, the Secretariat consulted with a range of stakeholders including auditors, preparers, consultants, professional bodies and other interested parties.

Board Members: Mr V Jack (Chairperson), Ms CJ Kujenga, Mr K Kumar, Mr K Makwetu, Mr F Nomvalo, Mr G Paul,
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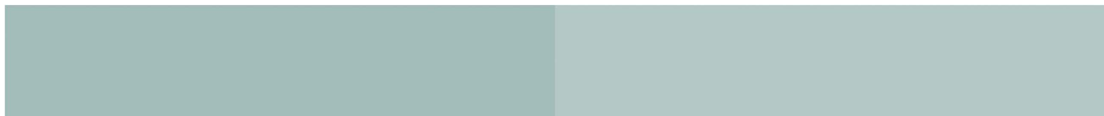

Please feel free to contact me should you have any queries relating to this letter.

Yours sincerely,

Erna Swart

CEO: Accounting Standards Board

PRELIMANARY VIEWS

Preliminary view 1 (following paragraph 2.16)

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

The key definitions are as follows:

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

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

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

*(d) An **operation** is an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services.*

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

*(f) 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.*

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

We support the proposed definition for a public sector combination as well as the proposed key definitions. We do however have the following comment on, and proposals to the definitions for amalgamation, combining operation and resulting entity.

Definition for amalgamation and combining operation

An amalgamation is defined as a transaction or other event where two or more operations combine, none of the combining operations gain control of the other operations, and the transaction or other event is not the formation of a joint venture.

We question the reference to an operation in the definition of an amalgamation, because an operation (as defined in this Consultation Paper) is an integrated set of activities and related assets and/or liabilities. The pooling of interest method as discussed in IAS 22 *Business Combinations* noted that the combined entity has to recognise the assets, liabilities and equity of the combining entities, thereby assuming that the entire entity is amalgamated into the new combined entity and would be dissolved after the amalgamation. Furthermore the explanatory guidance distinguishing an acquisition from an amalgamation as included in section 3 refers to a combining entity, which also assumes the amalgamation of an entire entity. When reading the proposals concerning the going concern concept in paragraphs 7.13 to 7.15, we also concluded that, after the amalgamation, the entities combining will be dissolved.

If the definition of an amalgamation requires the combination of two or more *operations* it assumes that some of the operations, ie an integrated set of activities and related assets and/or liabilities, may remain in the combining entity after the amalgamation.

We therefore suggest that sufficient explanatory guidance should be included in the text of the proposed pronouncement to explain that an operation can either be a unit of an entity, or a transfer of the entire entity. Sufficient explanatory guidance should also be included to explain how entities should distinguish between an acquisition and an amalgamation if both these transactions can involve the transfer of an integrated set of activities and related assets and/or liabilities.

Definition for resulting entity

We propose that the definition for "resulting entity" could be condensed by deleting the last part of the definition, ie where none of the combining operations gains control of the other operations. This part of the definition is already included in the definition of an amalgamation.

Other proposals

The definition for "an acquisition" refers to "other events". In discussing the proposals in the Consultation Paper with stakeholders, it was noted that "other events" could include, amongst others, the promulgation of legislation to require the public sector combination.

To ensure that the meaning of "other events" is interpreted consistently when preparers consider the principles in the pronouncement dealing with public sector combinations, we propose that sufficient explanatory guidance should be included in the proposed pronouncement to explain what "other events" can entail.

Preliminary view 2 (following paragraph 2.22)

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

We support the proposed definition for a public sector combination under common control.

We acknowledge that entities should apply judgement in determining whether a transaction or event has occurred between entities "under common control" or "not under common control", but we suggest that the proposed pronouncement dealing with public sector combinations should provide sufficient guidance to assist preparers in selecting the appropriate accounting guidance in accounting for the public sector combination.

In addition, we suggest that concept of "ultimately controlled" should be sufficiently explained in the proposed pronouncement to be developed for public sector combinations.

Preliminary view 3 (following paragraph 3.13)

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

We support the sole criterion for distinguishing between an amalgamation and an acquisition as being that none of the combining operations gains control of the other operations.

We do however suggest that the guidance in the proposed pronouncement dealing with public sector combinations should discuss other criteria that could be considered to explain

when control could, or could not exist, such as representation of management in the resulting entity and the sizes of the entities and/or operations involved in the amalgamation.

Preliminary view 4 (following paragraph 5.5)

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

We support the view that an acquisition not under common control should be recognised on the date that the recipient gains control of the acquired operation, which can be different to the date specified in the binding arrangement that governs the acquisition.

We suggest that the proposed pronouncement dealing with public sector combinations should discuss the concept of substance over form, ie that although the legal acquisition date is specified in legislation, actual control over the assets acquired and liabilities assumed might be obtained at a later or an earlier date (due to, for example budgetary issues), to ensure that the principles are applied consistently in accounting for the public sector combination.

We also propose that the concept of "acquisition date" and how it should be determined should be explained in the proposed pronouncement.

Preliminary view 5 (following paragraph 5.46)

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

(a) A gain where the recipient acquires net assets in excess of consideration transferred (if any); and

(b) A loss where the recipient assumes net liabilities.

We support the view that the difference arising in an acquisition not under common control should be recognised in the statement of financial performance as either a gain or a loss.

Preliminary view 6 (following paragraph 6.6)

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

As with our comment to preliminary view 4 above, we support the view that an acquisition under common control should be recognised on the date that the recipient gains control of the acquired operation, which can be different to the date specified in the binding arrangement that governs the acquisition.

We also suggest that the proposed pronouncement dealing with public sector combinations should discuss the concept of substance over form , ie that although the legal acquisition date is specified in legislation, actual control over the assets acquired and liabilities assumed might be obtained at a later or an earlier date.

We also propose that the concept of "acquisition date" and how it should be determined should be explained in the proposed pronouncement.

Preliminary view 7 (following paragraph 6.9)

The recipient in an acquisition UCC recognizes in its financial statements on the date of acquisition the carrying amounts of the assets and liabilities in the acquired operation's

financial statements, with amounts adjusted to align the operation's accounting policies to those of the recipient.

We support the view that the recipient should recognise the carrying amounts of the assets and liabilities in its financial statements on the date of acquisition for a transaction or event that occurred between entities under common control, with amounts adjusted to align the operation's accounting policies with its own.

The proposal to use carrying amounts is supported because:

- If carrying amounts are used by both the recipient and transferor, no gain or loss is recognised by either party as opposed to remeasuring those assets and liabilities to fair value.
- Gains and losses are not recognised as the entity that ultimately controls the recipient and transferor is merely transacting with itself.
- No additional costs need to be incurred to revalue the assets and liabilities acquired.

We do however suggest that consideration should be given to the inclusion of the following guidance in the proposed pronouncement dealing with public sector combinations:

(a) The recipient and transferor need to apply the same accounting bases prior to the public sector combination to ensure that the carrying amounts of the assets and liabilities transferred are measured on the same basis. For example, if the transferor applied a cash-basis of accounting and the recipient applied an accrual basis of accounting, the assets acquired and liabilities assumed need to be reflected at an accrual basis before the recipient can recognise the assets acquired and liabilities assumed in accounting for the public sector combination.

    Another example will be where a Government Business Enterprise (GBE), ie the transferor, was applying IFRSs prior to the acquisition in, for example the accounting for government grants, while the recipient is applying IPSASs. Prior to the acquisition, the accounting basis of the GBE should be aligned with the accounting principles in the applicable IPSAS.

    We further suggest that the adjustments to the assets and liabilities to align the accounting bases of the recipient and transferor should be made on the acquisition date, prior to aligning the operation's accounting policies to those of the recipient.

(b) When adjustments are required to the assets acquired and liabilities assumed in the public sector combination, guidance should be provided on the treatment of the adjustments, as well as the party responsible for making these adjustments.

    We suggest that the recipient should make the necessary adjustments to the basis of accounting for the assets it acquires and the liabilities it assumes in the public sector combination. We also suggest that the recipient should account for these adjustments in a similar manner as the difference between the consideration transferred (if any) and the assets acquired and liabilities assumed.

<u>Preliminary view 8 (following paragraph 7.12)</u>

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

We support the application of the modified pooling of interest method of accounting by the resulting entity.

However, we propose that the proposed pronouncement dealing with public sector combinations should provide guidance on adjusting the carrying amounts of the combining operation's assets acquired and liabilities assumed to the accounting basis that is applied by the resulting entity on the date of amalgamation. We also suggest that guidance should be provided on the treatment of these adjustments, as well as the party responsible for making these adjustments (also see our proposed suggestions to preliminary view 7 above).

Preliminary view 9 (following paragraph 7.15)

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

Even though the principle of going concern is addressed in other IPSASs, we support the view that the proposed pronouncement dealing with public sector combinations should remind and require the combining operation to continue to prepare and present its financial statements on a going concern basis where the resulting entity will fulfill that entity's responsibilities following the amalgamation.

SPECIFIC MATTERS FOR COMMENT

Specific matter for comment 1 (following paragraph 2.49)

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

We support the scope of this Consultation Paper, but suggest that, in the absence of an IPSAS dealing with non-current assets held for sale and discontinued operations, the proposed pronouncement dealing with public sector combinations should include some guidance, specifically around the required disclosure requirements, to be considered by a transferor in a public sector combination under common control.

Specific matter for comment 2 (following paragraph 2.49)

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

We support the approach used in the Consultation Paper to distinguish acquisitions and amalgamations and public sector combinations under common control and not under common control.

Specific matter for comment 3 (following paragraph 3.13)

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

We are not aware of any other public sector characteristics that should be considered in determining whether one party has gained control of one or more operations.

Specific matter for comment 4 (following paragraph 5.25)

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

(a) Applying fair value measurement to the identifiable assets acquired and liabilities assumed in the operation at the date of acquisition for all acquisitions (Approach A);

(b) Distinguishing between different types of acquisitions (Approach B) so that:

(i) For acquisitions where no or nominal consideration is transferred, the carrying amounts of the assets and liabilities in the acquired operation's financial statements are recognized, with amounts adjusted to align the operation's accounting policies to those of the recipient, at the date of acquisition; and

(ii) For acquisitions where consideration is transferred, fair value measurement is applied to the identifiable assets acquired and liabilities assumed in the operation, at the date of acquisition; or

(c) Another approach?

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

We support option (a) that requires the application of fair value measurement to the identifiable assets acquired and liabilities assumed in the operation at the date of the public sector combination not under common control.

We are of the view that it would be difficult to determine when the consideration received is “nominal” in as this will require a high degree of judgement which could effect comparability between entities. What one entity sees as a “nominal consideration” might be different to what another entity sees as “nominal” due to nature of the arrangement or due to different circumstances under which the transaction or event is undertaken.

Specific matter for comment 5 (following paragraph 5.46)

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

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

(b) Goodwill for all acquisitions (which would require development if a definition of goodwill that encompasses the notion of service potential); or

(c) A loss for all acquisitions?

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

We support option (c) that requires that the difference arising in an acquisition not under common control, where consideration is transferred, should be recognised as a loss in the recipient’s financial statements.

For an item to meet the definition of an asset, future economic benefits or service potential should be obtainable from that item. In applying that principle to the excess of the net assets acquired, the recipient should be able to demonstrate that the projected future results of operations of the acquired entity would be sufficient to recover the purchase premium over its amortisation period. The transferor should be able to provide supportive evidence on projected future results through, for example a realistic and specific business plan.

As public sector entities are not focused on generating a commercial return but rather on providing goods and services to achieve their objectives, and because the excess is likely to have been paid for policy reasons, we are of the view that it is more appropriate to recognise the excess as a loss. In our view the definition of goodwill, as defined in IFRS 3 *Business Combinations,* has not been met.

Specific matter for comment 6 (following paragraph 6.26)

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

(a) A gain or loss recognized in surplus or deficit (in the statement of financial performance);

(b) A contribution from owners or distribution to owners recognized directly in net assets/equity in the statement of financial position) or;

(c) A gain or loss recognized directly in net assets/equity (in the statement of financial position), except where the transferor is the ultimate controlling entity and then the gain or loss meets the definition of a contribution of distribution to owners?

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

We do not support alternative (a) or (b) provided under this matter for comment.

In our view, the difference arising in an acquisition under common control does not constitute a gain or loss and also does not meet the definition of a contribution from owners or distribution to owners. We therefore do not support option (a) or (b).

We believe the difference arising in an acquisition under common control should be recognised directly in net assets/equity (accumulated surplus and deficit) as the transaction between the recipient and the transferor represents a transaction with owners that occurred between entities under common control. The recipient is thus entitled to the transferor's portion of the accumulated surplus or deficit that relates to the assets transferred and liabilities relinquished. The treatment of the difference against accumulated surplus or deficit will also be eliminated on consolidation. This view is to some extent addressed in alternative (c) (ie first part of the alternative excluding the exception).

Specific matter for comment 7 (following paragraph 6.31)

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

We are of the view that the accounting treatment for the recipient and transferor in an acquisition under common control should be symmetrical as it represents a transaction with owners.

Even though we support the symmetrical accounting treatment, we suggest that the proposed pronouncement dealing with public sector combinations should note that the values at which the assets and liabilities are transferred by the transferor, and the values at which the assets and liabilities are assumed by the recipient might be different in certain instances. These differences result, for example, from the application of different accounting bases applied by the recipient and transferor (see our response and proposed suggestions to preliminary view 7 above).

OTHER MATTERS

Summary of methods of accounting

In table 2: Summary of methods of accounting, it is concluded that under the pooling of interest method and the modified pooling of interest method the consideration transferred only involves the exchange of shares.

We suggest that the basis for conclusions of the proposed pronouncement dealing with public sector combinations should explain why the consideration only involves the exchange of shares.