



KPMG Services Proprietary Limited
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30 June 2016

Dear Sir/Madam

COMMENT ON EXPOSURE DRAFT 60: PUBLIC SECTOR COMBINATIONS

The Technical Director

International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto, Ontario M5V 3H2 Canada

We welcome the opportunity to comment on Exposure Draft 60: *Public Sector Combinations*.


Exposure Draft 60: *Public Sector Combinations* aims to establish requirements for classifying, recognizing and measuring public sector combinations.

Overall, we are supportive of the IPSASB's Exposure Draft 60: *Public Sector Combinations*. Our response to the specific matters for comment are listed below.

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

Yours sincerely

KPMG Services Proprietary Limited



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Policy Board
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Executive Directors: N Dlomu, M Letsitsi, SL Louw, NKS Malaba,
M Oddy, M Saloojee, CAT Smit

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AH Jaffer (Chairman of the Board), FA Karreem,
ME Magondo, F Mall, GM Pickering,
JN Pierce, T Rossouw, GCC Smith

KPMG Services Proprietary Limited is a company incorporated under the South African Companies Act and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

KPMG Services Proprietary Limited is not a Registered Auditor in terms of the Auditing Profession Act, 26 of 2005 and does not provide audit services as defined in Section 1 of this Act.

Registration number 1999/012876/07

The company's principal place of business is at KPMG Crescent, 85 Empire Road, Parktown, where a list of the directors' names is available for inspection.

SPECIFIC MATTERS FOR COMMENT

Specific Matter for Comment 1:

Do you agree with the scope of the Exposure Draft? If not, what changes to the scope would you make?

We support the proposed scope of the Exposure Draft.

Specific Matter for Comment 2:

Do you agree with the approach to classifying public sector combinations adopted in this Exposure Draft (see paragraphs 7–14 and AG10–AG50)? If not, how would you change the approach to classifying public sector combinations?

We agree with the approach to classify public sector combinations as either an amalgamation or an acquisition, based on whether a party to the combination gains control of one or more operations as a result of the combination, as well as the indicators listed in paragraphs 12 and 13.

We are of the opinion that the indicators in paragraphs 12 and 13 should be regarded as criteria, to ensure that they are not perceived to be optional, but that one of the criteria is required to be met, for a public sector combination where one party gains control of one or more operations as a result of the combination, to be classified as an amalgamation. This will result in consistent application of the Standard.

Paragraphs 11 and 14 relate to instances where the indicators provide insufficient evidence to determine whether the presumption is rebutted, and judgement has to be used to determine the economic substance of the public sector combination. We are of the view that allowing such instances will result in different classifications of similar public sector combinations, due to different interpretations of the Standard and the amount of judgement involved in determining those classifications. It would be advisable to extend the list of criteria required to be met for the public sector combination to be classified as an amalgamation, rather than to allow for instances where the criteria is not decisive.

Specific Matter for Comment 3:

Do you agree that the modified pooling of interests method of accounting should be used in accounting for amalgamations? If not, what method of accounting should be used?

We agree that the modified pooling of interests method of accounting should be used to account for amalgamations.



In South Africa, the Accounting Standards Board (ASB) is the national public entity charged with developing and maintaining financial reporting standards that lead to proficient performance in the public sector, namely Standards of Generally Recognised Accounting Practice (GRAP). GRAP 107: *Mergers* was issued in November 2010 and takes a similar approach to the modified pooling of interest method.

GRAP 107: *Mergers* requires the combined entity to recognise all the assets acquired and liabilities assumed at their carrying amounts, similar to ED 60. GRAP 107: *Mergers*, however requires the difference between the carrying amounts of assets and liabilities (net assets/equity) to be recognised in Accumulated surplus/deficit, compared to the residual amount being recognised outside of Accumulated surplus/deficit per ED 60.

We agree that the residual amount should be recognised directly in net assets/equity, and the Accumulated surplus/deficit and Revaluation surplus opening balances should be zero, as the new entity would not have generated such surpluses.

We are of the opinion that the Residual amount should be a distributable reserve. The new entity will need to be able to distribute from the Residual amount if there are future revaluation decreases, limited to the sum of the original Revaluation surpluses in the combining entities' records. To add on, if the funds previously held by the combining entities become repayable to Treasury, the new entity should also be able to make a distribution from the Residual amount, limited to the sum of the Accumulated surpluses/deficits in the combining entities' records.

Specific Matter for Comment 4:

Do you agree to adjustments being made to the residual amount rather than other components of net assets/equity, for example the revaluation surplus? If not, where should adjustments be recognized?

We agree that adjustments made during the amalgamation process, such as intercompany eliminations and accounting policy adjustments, should be made to the Residual amount rather than other components of net assets/equity.

Do you agree that the residual amount arising from an amalgamation should be recognized:
(a) In the case of an amalgamation under common control, as an ownership contribution or ownership distribution; and
(b) In the case of an amalgamation not under common control, directly in net assets/equity?
If not, where should the residual amount be recognized?

We are of the opinion that the Residual amount arising from an amalgamation should be recognised directly in net assets/equity, regardless of whether it is an amalgamation under common control or not. None of the combining entities gain control of one or more operations as a result of the amalgamation, therefore, neither entity becomes the owner of the other and the Residual amount cannot result from an ownership contribution or ownership distribution.

Specific Matter for Comment 5:

Do you agree that the acquisition method of accounting (as set out in IFRS 3, Business Combinations) should be used in accounting for acquisitions? If not, what method of accounting should be used?

We agree that the acquisition method of accounting as per IFRS 3 should be used in accounting for acquisitions. However, we are concerned that determining the fair value of all identified assets and liabilities in a public sector combination might not be practical in certain cases. We acknowledge the exceptions to the recognition and measurement principles listed in par. 73 – 82 of ED60, but feel that those exceptions are not all-inclusive. We suggest that additional guidance on the measurement requirements be provided for exceptions not specifically listed (such as heritage assets/specialised intangible assets, etc.). A possible approach could be to measure all assets, for which the fair value can be reliably measured, at fair value and all other assets at carrying value/deemed cost as per IPSAS 33: *First Time Adoption of IPSAS*.

Per paragraph 84 of ED60, the acquirer shall recognise goodwill only to the extent that the acquisition will result in the generation of cash inflows and/or a reduction in the net cash outflows of the acquirer. In our opinion, goodwill should not be recognised for acquisitions in the public sector. Public sector entities will experience significant challenges in determining the increase in cash inflows or decrease in net cash outflows directly attributable to the acquisition. The entities might also have to incur significant costs to determine these cash flows. In addition, the subsequent testing of impairment of the goodwill will be complex and challenging for public sector entities. We recommend that the difference between the consideration transferred including non-controlling interest, less the identifiable assets and liabilities, be recognised as part of the residual amount in net assets/equity.



OTHER COMMENTS

Measurement period

Paragraph 102 states that the measurement period shall not exceed one year from the acquisition date. We are of the opinion that a two year measurement period may be more appropriate, as the acquirer will need to determine the fair value of the identifiable assets acquired and liabilities assumed. As noted in our response to Specific Matter for Comment 5, the acquirer might experience challenges in determining these fair values. Whilst the one year measurement exemption might be suitable for private sector entities, it might be difficult for public sector entities to determine the fair value of certain assets and liabilities and thus a longer measurement period is proposed.

Guidance for combining entities

ED 60 does not provide accounting and disclosure requirements for the combining entities. We recommend that accounting and disclosure requirements with regards to the de-recognition of the combining entities' assets and liabilities be provided in the IPSAS Standard on Public Sector Combinations.

Disclosure of the intended combination

ED 60 does not provide disclosure requirements with regards to the entities' intention to undertake a public sector combination. We recommend that disclosure requirements be provided in the IPSAS Standard on Public Sector Combinations. Possible disclosure requirements include the intent to undertake a public sector combination, the nature and reasons for the combination taking place and the financial implications of the combination.

