



Accounting Standards Board

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

The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto, Ontario M5V 3H2 Canada
Per e-mail

27 June 2016

Dear John,

COMMENT ON EXPOSURE DRAFT 60 PROPOSED IPSAS ON *PUBLIC SECTOR COMBINATIONS*

We welcome the opportunity to comment on Exposure Draft 60 (ED 60) on the Proposed IPSAS on *Public Sector Combinations*. We support the development of guidance on accounting for combinations as this will ensure that entities consistently account for acquisitions and amalgamations undertaken in the public sector.

Our responses to the specific matters for comment are included as Annexure A, while other comments are included as Annexure B to this letter.

The views expressed in this letter are those of the Secretariat and not the Accounting Standards Board (Board). In formulating our comments, the Secretariat consulted with a range of stakeholders including auditors, preparers, consultants, professional bodies and other interested parties.

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

Yours sincerely

A handwritten signature in black ink, appearing to read 'J Poggiolini', written in a cursive style.

Jeanine Poggiolini, Technical Director

Board Members: Ms T Coetzer, Mr B Colyvas, Ms I Lubbe, Mr M Kunene, Mr K Makwetu,
Mr V Ndzimande, Ms N Ranchod, Ms R Rasikhinya, Ms C Wurayayi
Alternates: Mr S Badat, Ms L Bodewig
Chief Executive Officer: Ms E Swart Technical Director: Ms J Poggiolini

ANNEXURE A – 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?

Yes, we agree with the scope proposed in 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 broadly classify public sector combinations into an acquisition or amalgamation based on whether a party to a public sector combination gains control of one or more operations. We also support the principle that requires a public sector combination to be classified as an amalgamation where no party gains control of one or more operations.

While we support the principle that an acquisition has occurred if one party gains control over one or more operations, we are of the view that acquisitions should further be classified based on whether the acquisition has occurred between entities under common control or not under common control.

We believe that all combinations under common control should be accounted for using similar accounting proposed for amalgamations.

We believe that acquisitions not under common control should be accounted for by considering the economic substance of the combination.

Public sector combinations under common control

Public sector combinations undertaken between entities under common control are likely to be undertaken as a result of a decision imposed by a third party without any party to the combination being involved in the decision-making process. It is usually the ultimate controlling entity that decides which operations should be combined. As the ultimate controlling entity decides which operations should combine, this is an indication that there is no overall change in control of the operations, and ultimately, in the underlying assets and liabilities.

In accounting for combinations undertaken between entities under common control, we propose that the modified pooling of interest method should be applied (as for amalgamations). We believe that this method should be used because requiring the identifiable assets and liabilities to be measured at their carrying amounts is appropriate for the following reasons:

- (a) There is no overall change in control as the entity is merely transacting with itself.
- (b) As control already exists, no gain or loss should be recognised by either party to the public sector combination when identifiable assets and liabilities are measured.
- (c) It is inappropriate to incur costs to identify assets and liabilities and revalue them at fair value when there has been no change in control. Measuring the identifiable assets and

liabilities at carrying values will also avoid inflating the statements of financial position and performance.

- (d) The objective of these combinations is most often aimed at improving service delivery. As such, acquisition accounting will not reflect the economic reality of these types of combinations.

Although we support the use of the modified pooling of interests method for all combinations that occur under common control, we believe that comparative information should be presented as the operation existed prior to the combination taking place and the operation was controlled by the same party both before and after the transaction.

Public sector combinations not under common control

When a public sector combination is undertaken between entities not under common control, there are instances in the public sector when the transaction has commercial substance and is undertaken on commercial terms. In these instances, we support the proposal that the combination should be accounted for by applying the acquisition method, similar to that in the private sector. This method is appropriate as fair value accounting reflects the substance and economic reality of the combination undertaken between the parties.

We do however believe that a large number of acquisitions occur in the public sector that do not have commercial substance. In these instances, it is important to consider the substance of the transaction as the proposed accounting for acquisitions, in particular the use of fair value, is inappropriate. We believe that applying the indicators in paragraphs .12(a) and (b), and .13(a) and (b), should be considered to assess the substance and economic reality of the transactions undertaken.

At present, the criteria in paragraph .12 and .13 are merely rebuttable presumptions. We are of the view that an entity should be required to consider whether the criteria in paragraph .12 and .13 exist, and if yes, apply the same accounting treatment as amalgamations.

In conclusion

We therefore propose that public sector combinations should be classified between (a) an amalgamation, where no party to the public sector combination gains control of one or more operations, or (b) an acquisition where a party to the public sector combination gains control of one or more operations.

Acquisitions should be distinguished between combinations undertaken between entities:

- under common control; and
- not under common control. If an entity demonstrates the criteria in paragraphs .12 and .13, the transaction should be accounted for in the same way as an amalgamation.

We further propose that combinations undertaken between entities under common control should be accounted for by applying the modified pooling of interest method (ie the same as for amalgamations), with the exception that prior period information should be presented for all the entities that are party to the combination.

Combinations undertaken between entities not under common control, except those that demonstrate the criteria in paragraphs .12 and .13, should be accounted for by applying the acquisition method as proposed in the Exposure Draft.

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 with the application of the modified pooling of interest method in accounting for amalgamations.

Following our comment to Specific Matter for Comment 2, we propose that combinations undertaken between entities under common control, and combinations undertaken between entities not under common control, where the entity has demonstrated the criteria in paragraphs .12 and .13, should both be accounted for by applying the modified pooling of interest method (i.e. the same as an amalgamation).

Paragraphs .49 and .50 of the Exposure Draft require that in applying the modified pooling of interest method, the resulting entity shall not present financial statements for periods prior to the amalgamation date as a new entity is formed following the amalgamation. If the modified pooling of interest method is applied to combinations that were undertaken between entities under common control, or combinations that were undertaken between entities not under common control where the entity demonstrates the criteria in paragraphs .12 and .13, we believe that comparative information should be presented as these operations existed prior to the combination.

Combinations undertaken between entities not under common control where the criteria in paragraphs .12 and .13 could not be demonstrated, should account for the combination by applying the acquisition method as proposed in the Exposure Draft.

Specific Matter for Comment 4(a)

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 recognised?

Yes, we agree that adjustments should be made to the residual amount rather than to other components of net assets/equity.

Specific Matter for Comment 4(b)

Do you agree that the residual amount arising from an amalgamation should be recognised:

- (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 recognised?

Based on our comment to Specific Matter for Comment 2 above, we are of the view that an amalgamation should not be separated between an amalgamation undertaken between entities under common control, and entities not under common control. We are of the view that this distinction should only be made for acquisitions.

In accounting for the residual amount arising from an amalgamation, we are of the view that the difference should be recognised directly in net assets/equity. As there is no party gaining control in an amalgamation, the residual cannot result from an ownership contribution or

ownership distribution, as no owner is identified in an amalgamation. We therefore support option (b) in accounting for the residual amount in all amalgamations, irrespective of whether the amalgamation was under common control, or not under common control.

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?

As noted in our response to Specific Matter for Comment 2, we are of the view that a distinction should be made between acquisitions undertaken between entities under common control, and entities not under common control.

We agree that the acquisition method of accounting (as set out in IFRS 3 *Business Combinations*) should be used in accounting for acquisitions undertaken between entities not under common control where the entity does not meet the criteria in paragraphs .12 and .13, as the application of the acquisition method reflects the commercial substance of the combination undertaken between the parties. Those acquisitions that are undertaken between entities under common control, or when the combination is undertaken between entities not under common control, but where the entity demonstrates the criteria in paragraphs .12 and .13, should be accounted for using the modified pooling of interests method.

Treatment of residual amount

Paragraph .84 requires that goodwill should be recognised to the extent that the acquisition will result in (a) the generation of cash inflows and/or (b) a reduction in the net cash outflows of the acquirer.

We are of the view that applying this principle practically in the public sector will pose challenges, as determining what portion of the acquisition will result in an increase in cash inflows, or a reduction in cash outflows, may not be that straight forward. In addition, any goodwill recognised will need to be tested for impairment, which is complex and often subjective.

As a result, we propose that the residual amount in public sector combinations that are classified as acquisitions that are undertaken between entities not under common control where the entity does not demonstrate the criteria in paragraphs .12 and .13, should be recognised in net assets/equity. As public sector entities' primary focus is not to generate a commercial return, we are of the view that it is more appropriate to recognise the residual amount in net assets/equity.

If the IPSASB retains the requirement to recognise goodwill, it should only be recognised by an acquirer if it is able to demonstrate that the projected future cash inflows of the operations of the acquired entity would be sufficient to recover the purchase premium. The acquiree should be able to provide supportive evidence on projected future cash inflows through, for example, a realistic and specific business plan.

ANNEXURE B – OTHER COMMENTS

Disclosure requirements

The proposed Exposure Draft does not propose any disclosures in relation to entities' intention to undertake a public sector combination, prior to the combination taking place.

We therefore propose that the Exposure Draft includes disclosures that inform the users of the financial statements of the intended public sector combination, prior to the combination being effected. These disclosure should provide a description of:

- (a) the reason for undertaking the intended public sector combination;
- (b) facts and circumstances that can influence the public sector combination, or leading to the expected combination; and
- (c) the expected manner and timing of the public sector combination.

These disclosures should be provided by the entity that will be transferring the operation, as well as by the entity that will acquire the operations.

In addition, we propose that disclosures should be provided once the combination is effected to allow the users of the financial statements to understand the financial effect and implications of the combination on the entity who has transferred the operations, as well as on the entity that has acquired the operations.

Rebuttable presumption in relation to the consideration

We question the indicator included in paragraph .12(c). In the public sector "government" in general will be entitled to the net assets of a transferred entity in the absence of any other specific entity. We therefore question the relevance of the indicator that indicates that the presumption will be rebutted when "no-one with an entitlement to the net assets of a transferred entity can be identified". When a combination involves public sector entities, we are of the view that there will always be a party that can be identified as the recipient of an entitlement to the net assets/equity of the transferred entity, even if this party is government in general.

We therefore propose that this indicator should be deleted as it is inappropriate.

Measurement period

We agree with the measurement period of one year where an entity is required to apply the modified pooling of interest method.

Obtaining fair values for some public sector assets is more complex due to their nature (for example infrastructure assets). As a result, an entity may need more time to obtain appropriate fair values for these assets and/or liabilities.

We therefore recommend that a two year measurement period should be considered when an entity is required to apply the acquisition method. A two year measurement period is more reasonable to allow the acquirer to identify and measure the identifiable assets acquired and liabilities assumed in a public sector combination.

Definition of amalgamation date

We recommend that the definition of an amalgamation date be amended as follow “is the date on which the resulting entity obtains control of the identifiable assets and liabilities from the resulting entity in an amalgamation”.

As an amalgamation is a public sector combination in which no party gains control of one or more operations, we recommend that “control” in the definition of an amalgamation date, should be clarified.