IPSASB

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Exposure Draft (ED) 60 Summary—*Public Sector Combinations*

This summary provides an overview of Exposure Draft (ED) 60, *Public Sector Combinations.*

Project objectives: To establish requirements for classifying, recognizing and measuring public sector combinations.

The project and stage: The International Public Sector Accounting Standards Board® (IPSASB®) issued the Consultation Paper (CP) *Public Sector Combinations*, in June 2012. The IPSASB issued Exposure Draft (ED) 60 in January 2016.

Next steps: The IPSASB seeks feedback on ED 60 to guide it in developing a final International Public Sector Accounting Standard™ (IPSAS™) that establishes requirements for accounting for public sector combinations.

Comment deadline: ED 60 is open for public comment until June 30, 2016.

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Why is the IPSASB Undertaking this Project?

The purpose of the IPSASB's project on public sector combinations is to establish requirements for classifying, recognizing and measuring public sector combinations.

Currently, IPSASs do not provide guidance on how to account for public sector combinations. Instead, other IPSASs explain that guidance on accounting for such combinations can be found in the relevant international or national accounting standard.

In the absence of an IPSAS dealing with public sector combinations, public sector entities may initially look to International Financial Reporting Standard (IFRS) 3, *Business Combinations*. However, IFRS 3 requires all combinations to be accounted for as acquisitions.

In developing IFRS 3, the International Accounting Standards Board (IASB) came to the conclusion 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 in the private sector. Consequently, the IASB decided that separate accounting requirements for such combinations was not necessary.

In contrast to this view, many consider that in the public sector, mergers or amalgamations are the most common form of combination.

Many also consider that there are other differences between the circumstances in which combinations occur in in the private and public sectors.

Examples of these differences include:

- The objective of most businesses and business combinations is to generate profits, whereas the objective of most public sector entities is to deliver goods and services for community or social benefit.
- Most business combinations arise as a result of exchange transactions, whereas many public sector combinations take place by way of non-exchange transactions.
- Most business combinations are voluntary. A public sector combination may be voluntary, or may be required by legislation or other authority.

As a result, many do not consider IFRS 3 appropriate when accounting for public sector combinations.

This absence of accepted guidance means that there may not be consistent or appropriate reporting of public sector combinations in the general purpose financial statements (GPFSs) of public sector entities. Consequently, users may not be able to obtain the information needed to evaluate the nature and financial effect of a public sector combination.

The IPSASB believes the proposals in ED 60, will promote consistency and comparability in how public sector combinations are reported by public sector entities.

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Scope and Definitions

ED 60 would apply to any transaction or other event that meets the definition of a **public sector combination**.

A public sector combination is defined as "the bringing together of separate operations into one entity."

Scope

The scope of ED 60 includes all transactions or other events that meet the definition of a public sector combination–the bringing together of separate operations into one entity.

Examples of public sector combinations include:

- Nationalizations;
- Restructurings of central government ministries;
- Reorganizations of local or regional governments, for example by rearranging territorial boundaries or by combining entities; and
- Transfers of operations from one government (or governmental unit) to another.

Public sector combinations involve the bringing together of operations. The following are therefore not public sector combinations:

- The acquisition or receipt of an asset or a group of assets that does not constitute an operation; and
- The assumption of a liability or a group of liabilities that does not constitute an operation.

The proposed IPSAS, ED 60, also excludes from its scope the accounting for the formation of a joint operation or joint venture.

Definitions

Key definitions in the proposed IPSAS, ED 60, include:

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.

An amalgamation gives rise to a resulting entity and is either:

(a) A public sector combination in which no party to the combination gains control of one or more operations; or

(b) A public sector combination in which one party to the combination gains control of one or more operations, and in which the presumption that such a combination is an acquisition is rebutted.

An acquisition is a public sector combination in which one party to the combination gains control of one or more operations, and in which the presumption that such a combination is an acquisition is not rebutted.

Classification of Public Sector Combinations

If no party to a public sector combination gains control of one or more operations as a result of the combination, the combination is classified as an amalgamation.

If one party to a public sector combination gains control of one or more operations as a result of the combination, there is a rebuttable presumption that the combination is classified as an acquisition.

The gaining of control of operations by a party to the combination is an essential element of an acquisition, but is not sufficient in itself to determine whether a combination is an acquisition.

Where one party to a public sector combination gains control of one or more operations as a result of the combination, there is a rebuttable presumption that the combination is an acquisition.

An entity considers the following indicators in determining whether that presumption is rebutted:

Indicators relating to consideration

The presumption may be rebutted where:

- Consideration is paid for reasons other than to compensate those with an entitlement to the net assets of a transferred operation for giving up that entitlement;
- Consideration is not paid to those with an entitlement to the net assets of a transferred operation; or
- Consideration is not paid because there is no-one (whether an individual or an entity) with an entitlement to the net assets of a transferred entity.

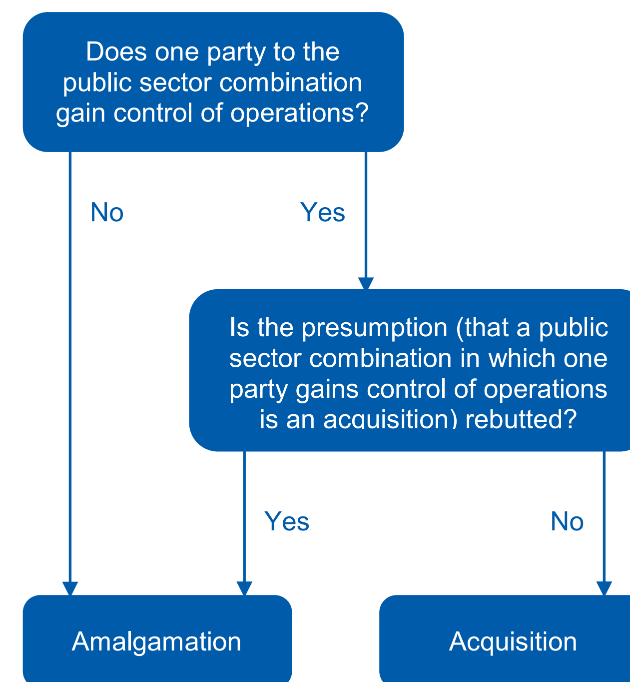
Indicators relating to the decision-making process

The presumption may be rebutted where:

- A public sector combination is imposed by a third party without any party to the combination being involved in the decision-making process;
- A public sector combination is subject to approval by each party's citizens through referenda; or
- A combination of operations under common control occurs.

The classification approach is summarized in Figure 1 below:

Figure 1: Classification Approach



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Accounting for Amalgamations

The **resulting entity** accounts for each amalgamation by applying the modified pooling of interests method of accounting.

The resulting entity is defined as “the entity that is the result of two or more operations combining in an amalgamation.”

The modified pooling of interests method of accounting is a variation of the pooling of interests method of accounting (sometimes referred to as “merger accounting”) in which the amalgamation is recognized on the date it takes place.

The modified pooling of interests method of accounting

Applying the modified pooling of interests method of accounting requires:

- Identifying the resulting entity;
- Determining the amalgamation date;
- Recognizing and measuring the assets received, the liabilities assumed and any non-controlling interest in the combining operations; and
- Recognizing and measuring the residual amount and other adjustments from an amalgamation.

The resulting entity:

- Recognizes the assets, liabilities and any non-controlling interests that are recognized in the financial statements of the combining operations as at the amalgamation date; and
- Measures them at their carrying amounts in the financial statements of the combining operations.

The carrying amounts are adjusted to conform to the resulting entity’s accounting policies (and in other limited circumstances, for example tax forgiveness).

The modified pooling of interests method of accounting recognizes the amalgamation on the date it takes place. As a consequence, no restated comparative information is required.

Residual amount

A residual amount might arise as a result of an amalgamation. This residual amount represents:

- For amalgamations not under common control, the past financial performance of the combining operations.
- For amalgamations under common control, the financial consequences of decisions made by the controlling entity in setting or accepting the terms of the amalgamation.

The modified pooling of interests method of accounting recognizes an amalgamation as giving rise to, in substance, a new entity on the date the amalgamation takes place. To ensure consistency with this timing, the IPSASB agreed that it is appropriate to recognize all items in net assets/equity as part of the residual amount, as the new entity would not have generated other components of net assets/equity such as accumulated surplus or deficit, or revaluation surplus.

The IPSASB accepted that this approach may have consequences for some entities. For example, any future revaluation decreases are more likely to be recognized in surplus or deficit. The IPSASB is seeking stakeholders’ views on this approach.

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Accounting for Acquisitions

The **acquirer** accounts for each acquisition by applying the acquisition method of accounting.

The acquirer is defined as "the entity that gains control of one or more operations in an acquisition."

Goodwill is defined as "an asset representing the future economic benefits arising from other assets acquired in an acquisition that are not individually identified and separately recognized."

The acquisition method of accounting adopted in ED 60, is that set out in IFRS 3, *Business Combinations*, supplemented by additional guidance for public sector specific circumstances.

The acquisition method of accounting

Applying the acquisition method of accounting requires:

- Identifying the acquirer;
- Determining the acquisition date;
- Recognizing and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation; and
- Recognizing and measuring goodwill, a gain or a loss from an acquisition.

The acquirer recognizes, separately from any goodwill recognized, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation. This may include items (for example, intangible assets) not previously recognized by the acquired operation.

The acquirer measures the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.

The proposed IPSAS, ED 60, provides limited exceptions to these recognition and measurement principles. For example, contrary to IPSAS 19, the acquirer recognizes a contingent liability assumed in an acquisition where consideration is transferred.

Goodwill, loss or gain from a bargain purchase

Goodwill is only recognized where consideration is transferred (or there is an exchange of equity instruments, which is not common in the public sector).

Goodwill is measured as the excess of:

- The aggregate of:
  - The consideration transferred;
  - The amount of any non-controlling interest in the acquired operation; and
  - In an acquisition achieved in stages, the fair value of the acquirer's previously held equity interest.

  over
- The net of the amounts of the identifiable assets acquired and the liabilities assumed.

Goodwill is only recognized to the extent that the acquisition will result in the generation of cash inflows or a reduction in the net cash outflows of the acquirer. Any additional excess is recognized as a loss.

In a bargain purchase, the net of the amounts of the identifiable assets acquired and the liabilities assumed may exceed any consideration paid. The acquirer recognizes the resulting gain in surplus or deficit.

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Next Steps

The deadline for comments is June 30, 2016.

During the comment period, IPSASB members are available to discuss the proposals with a wide range of parties.

How can I comment on the proposals?

The ED includes Specific Matters for Comment (SMCs) on which the IPSASB is seeking views.

Respondents may choose to answer all SMCs or just a selected few. The IPSASB welcomes comments on any other matters respondents think it should consider in forming its views.

Respondents are asked to submit their comments electronically through the IPSASB website, using the "Submit a Comment" link. Please submit comments in both a PDF and Word file.

All comments will be considered a matter of public record and will be posted on the IPSASB website.

The IPSASB will carefully consider all feedback and discuss responses at its public meetings after the comment period has ended.

Stay informed

The IPSASB's website will indicate the meetings at which feedback on ED 60 will be discussed. The dates, and, where known, the locations of 2016 meetings are available at:

http://www.ipsasb.org/meetings

To stay up to date about the project, please visit:

http://www.ipsasb.org/projects/public-sector-combinations