ISSUED MAY 2023

EXECUTIVE SUMMARY – ED 204 PROPOSED REVISIONS TO THE STANDARDS OF GRAP ON *TRANSFER OF FUNCTIONS BETWEEN ENTITIES UNDER COMMON CONTROL* (GRAP 105), *TRANSFER OF FUNCTIONS BETWEEN ENTITIES NOT UNDER COMMON CONTROL* (GRAP 106) AND *MERGERS (GRAP 107)*

This Executive Summary provides an overview of the proposed revisions to the Standards of GRAP on *Transfer of Functions Between Entities Under Common Control (GRAP 105), Transfer of Functions Between Entities Not Under Common Control (GRAP 106), and Mergers (GRAP 107)* (ED 204)	**Overview and project objective**	At the time GRAP 105, GRAP 106 and GRAP 107 (hereafter "the local Standards") were developed, an equivalent International Public Sector Accounting Standard (IPSAS) did not exist. IPSAS 40 on *Public Sector Combinations* was since issued in 2017. IPSAS 40 was compared with local Standards to identify any similarities and differences. Even though IPSAS 40 applies to combinations that are classified as either an amalgamation or an acquisition, the substance of combinations accounted for using IPSAS 40 is similar to that in the local Standards. Based on the outcome of the comparison, the Board agreed that the local Standards should be amended to include additional, authoritative guidance from IPSAS 40, where applicable and retain guidance in the local Standards not included in IPSAS, where appropriate. The Board also agreed to include amendments to the IFRS Accounting Standard on *Business Combinations* (IFRS 3) after the publication of IPSAS 40, as IFRS 3 was used to develop parts of the local Standards. The Board agreed that the three Standards of GRAP should be retained, rather than to issue an equivalent IPSAS. Local stakeholders understand when to apply a relevant Standard and to date, no significant application issues were raised.
	Consultation process	The proposed revisions to the local Standards were approved in March 2023, with a comment deadline of 15 July 2023. ED 204 can be accessed on https://www.asb.co.za/comment-on-proposals/.
	Next steps	The Board will analyse the comment on ED 204 at its December 2023 meeting. Once approved, the new Standards will replace the existing Standards of GRAP. A recommendation will be made to the Minister of Finance to determine the effective date for the revised Standards.

ACCOUNTING STANDARDS BOARD

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Overview of proposed revisions in ED 204	
Principles retained in the Standards of GRAP	
Measurement period	A measurement period allows an entity additional time to complete the recognition and measurement of a transfer of functions or merger if it is incomplete by end of the reporting period in which the transaction occurs. IPSAS 40 allows a measurement period of one year. The Board agreed to retain the two-year measurement period in the local Standards. From local practical experience, entities need more time to obtain the necessary information to identify and measure the assets and/or liabilities acquired, received or assumed.
Measurement principle	IPSAS 40 requires an acquirer to measure the assets acquired or received, and/or the liabilities assumed at the combining operation's carrying amounts as of the amalgamation or acquisition date. In the local Standards, the equivalent term for "combining operation" is "transferor or combining entity", and "amalgamation date" is "transfer or merger date". IPSAS 40 further requires that, prior to the combination, the acquirer should adjust the carrying amounts of the assets and/or liabilities of the combining operations to conform to the accounting policies to that of the combined entity. Adjustments also need to be made to eliminate transactions between parties involved in the combination in calculating the excess. To avoid additional costs to effect a transfer of functions or merger, the Board agreed to retain the measurement principles in GRAP 105 and GRAP 107. This means that no adjustments need to be made to the carrying amounts prior to the transfer or merger unless the transferor or combining entity(s) did not apply Standards of GRAP. Furthermore, no transactions between the parties involved in the transfer or merger need to be eliminated.

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Principles retained in local Standards of GRAP	
Presentation of financial statements prior to the transfer or merger	IPSAS 40 requires the resulting entity in an amalgamation to present financial statements prior to the amalgamation date. The equivalent terms for “resulting entity” in the local Standards are “acquirer” (GRAP 105) or “combined entity” (GRAP 107). The Board agreed to not include a similar requirement in GRAP 107 as a new legal entity will only be established after the merger. The combined entity will therefore not be required to present financial statements prior to the merger. Similarly in GRAP 105, the acquirer in a transfer of functions between entities under common control will only present its own activities and functions in its financial statements prior to the transfer.
Treatment of goodwill in GRAP 106	When the Board developed GRAP 106, it agreed to depart from the requirements in IFRS 3 on the treatment of the excess as goodwill. The treatment of the excess in IPSAS 40 is similar to that in IFRS 3. The Board concluded that in the public sector, the excess represents a premium paid by the acquirer to the previous owners which should not be capitalised. Furthermore the definition of an asset or liability in the *Framework for the Preparation and Presentation of Financial Statements* is not met to support the recognition of goodwill. In revising GRAP 106, the Board concluded that its decision to depart from IFRS 3 remains relevant. The Board noted that even if the excess meets the definition of an asset, the entity may not be able to reliably measure the goodwill. As a result, the ED proposes that the excess continues to be expensed on the transfer date.

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Proposed revisions: GRAP 105 to GRAP 107	
Proposed revisions: GRAP 105 to GRAP 107	Revisions that are proposed in the local Standards for consistency with IPSAS 40 include: • additional scope exclusions for (a) the formation of a joint arrangement in the financial statements of the joint arrangement itself; and (b) the transfer of an investment entity as defined in the Standard of GRAP on *Consolidated Financial Statements* (GRAP 35), or an investment in a controlled entity that is required to be measured at fair value through surplus or deficit; • aligning the definition of an acquirer, transferor, acquiree, function, combined entity, and merger date (including any related guidance); and • additional illustrative examples on the measurement period, disclosure requirements and to conclude if a transaction or event is a transfer of functions or merger.
Proposed revisions: GRAP 105 and GRAP 106	
Proposed revisions: GRAP 105 and GRAP 106	GRAP 105 and GRAP 106 deal with transfer of functions. The following guidance on acquisitions from IPSAS 40 are proposed in GRAP 105 and GRAP 106: • an additional factor to determine if a transaction is a separate transaction, or part of a transfer of functions, i.e., determining who initiated the transaction. The guidance clarifies that a transaction initiated by a transferor or acquiree is less likely to be for the benefit of the acquirer, but more likely to be part of the transfer of functions; and • examples of when control is obtained of a function in a non-exchange transaction, e.g. in a transfer of functions where the function has net liabilities, or a transfer by a donor that takes the form of a bequest.

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<table>
<tr><th colspan="2">Proposed revisions: GRAP 105</th></tr>
<tr><td>Proposed revisions:
GRAP 105</td><td>GRAP 105 provides guidance to an acquirer and transferor in a transaction or event that involves a transfer of functions between entities under common control.

The revisions propose the following additional disclosure requirements in GRAP 105 for the <u>acquirer and transferor</u>:

• the primary reason for the transfer of functions and a description of how control was obtained, for example, the legal basis that enabled the transfer of functions;
• as of the transfer date, the amounts recognised for each major class of assets acquired or received, and/or liabilities assumed or relinquished;
• the amount of acquisition-related costs if these were expensed. If the costs were not expensed, how they were recognised; and
• a requirement to provide the GRAP 105 disclosures for immaterial transfer of functions that are collectively material.

The following additional disclosure are proposed for the <u>acquirer</u>:

• if the transfer date is after the end of the reporting period, but before the financial statements are authorised for issue, the GRAP 105 disclosures should be provided, unless the initial accounting for the transfer of functions is incomplete when the financial statements are authorised for issue. In the latter, an acquirer should describe which disclosures could not be made, and the reasons therefore; and
• information that enables users of financial statements to evaluate the financial effects of adjustments in the current reporting period that relate to transfer of functions that occurred during the period, or in previous reporting periods.</td></tr>
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Proposed revisions: GRAP 106

Proposed revisions: GRAP 106	GRAP 106 provides guidance to an acquirer in a transaction or event that involves a transfer of functions between entities under common control. *Recognition conditions for intangible assets* Guidance is proposed for intangible assets acquired or received that are not identifiable at the acquisition date. Examples include an assembled workforce and potential binding arrangements that the acquiree negotiated at the acquisition date. *Measurement principles* The revisions propose the following measurement guidance: (a) non-controlling interests in the acquiree, to clarify that the interest in the acquiree should be measured at its fair value at the acquisition date, using valuation techniques unless a quoted price can be obtained with reference to an active market; and (b) assets that an acquirer intends not to use, or to use in a way that is different from the way other market participants would use them, to clarity that the asset should be measured at its fair value and subsequently be tested for impairment. *Exceptions to the recognition and measurement principles* Additional exceptions for recognition and measurement principles are proposed for: • liabilities and contingent liabilities within the scope of GRAP 19 on *Provisions, Contingent Liabilities and Contingent Assets* or IGRAP 19 on *Liabilities to Pay Levies*; • transfers, concessionary loans or similar benefits acquired or received by an acquirer or acquiree on the basis of criteria that may change as a result of the transfer of functions; and • when included in the transfer of functions, income taxes and forgiveness of tax due by an acquiree.

Proposed revisions: GRAP 106

Proposed revisions: GRAP 106 (continued)	*Disclosure requirements* The following additional disclosure requirements are proposed: • where a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer should explain the reason why along with the other disclosures required by GRAP 19; and • if the acquisition date is after the end of the reporting period, but before the financial statements are authorised for issue, the GRAP 106 disclosures should be provided, unless the initial accounting for the transfer of functions is incomplete when the financial statements are authorised for issue. In the latter, an acquirer should describe which disclosures could not be made, and the reasons therefore.

Proposed revisions: GRAP 107

Proposed revisions: GRAP 107	GRAP 107 provides guidance to a combined entity and combining entities in accounting for a transaction or event that meets the definition of a merger where no acquirer can be identified. *Exceptions to the recognition principles* Additional exceptions for the following recognition principles are proposed: • licence or similar rights previously granted by one combining entity to another combining entity; and • transfers, concessionary loans or similar benefits received by one combining entity on the basis of criteria that may change as a result of the merger.

Proposed revisions: GRAP 107	
Proposed revisions: GRAP 107 (continued)	*Additional disclosures* The revisions to GRAP 107 describes the composition of the combining entity's first set of financial statements following the merger. In addition, the following disclosures are proposed in GRAP 107 for the combined entity and combining entities: • the primary reason for the merger, a description of how the merger was governed and where applicable, the legal basis for the merger; • as of the merger date, the amounts recognised for each major class of assets acquired, received, or transferred, liabilities assumed or relinquished and any non-controlling interests; and • a requirement to provide the GRAP 107 disclosures for immaterial mergers that are collectively material. The revisions to GRAP 107 also propose additional disclosures for combining entities. A combining entity is required to present the GRAP 107 disclosures if the merger date is after the end of the reporting period, but before the financial statements are authorised for issue, unless the initial accounting for the merger is incomplete at the time the financial statements are authorised for issue. In the latter, the combined entity is required to describe which disclosures could not be made, and the reasons therefore.

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Proposed guidance from IFRS 3	
IFRS 3 guidance proposed for GRAP 105 and GRAP 106	In addition to revising the definition and explanatory text of a function in GRAP 105 and GRAP 106 with the IFRS 3 guidance, two new areas of guidance are proposed in these Standards of GRAP: (a) an optional test (concentration test) to assess if an acquired or received set of activities, assets and/or liabilities is a not function; and (b) assessing if an acquired or received process is substantive. *Optional test to assess if an acquired or received set of activities, assets and/or liabilities is a function* The proposed guidance allows an entity to apply the optional test, separately to each transaction or event. The test involves a simplified assessment of whether a transferred set of activities and assets, and/or liabilities is not a function. The test is met if substantially all of the carrying amounts of the gross assets acquired or received is concentrated in a single asset, or group of similar assets. If the test is not met, or if the entity elects not to apply the test, the entity needs to assess if the definition of a function in GRAP 105 or GRAP 106 is met. *Assessing whether an acquired or received process is substantive* A function consists of inputs and processes applied to those inputs to create outputs. Although a function usually has outputs, outputs are not required for the activities, assets and/or liabilities to be a function.

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<table>
<tr><th colspan="2">Proposed guidance from IFRS 3</th></tr>
<tr><td>IFRS 3 guidance proposed for GRAP 105 and GRAP 106 (continued)</td><td>For the definition of a function to be met, the proposed guidance clarifies that an acquired set of activities and assets and/or liabilities must include, at a minimum, an input and a substantive process that together significantly contribute to an entity’s ability to create outputs.

If there are no outputs at the transfer date, the acquired or received process is considered substantive only if:

(a) it is critical to the ability to develop or convert a transferred input or inputs into outputs; and

(b) the inputs transferred include both an organised workforce that has the necessary skills, knowledge, or experience to perform that process, and other inputs that the organised workforce could develop or convert into outputs.

If there are outputs at the transfer date, the acquired or received process is considered substantive only if it is:

(a) critical to the entity’s ability to continue producing outputs, and the inputs acquired or received include an organised workforce with the necessary skills, knowledge, or experience to perform that process; or

(b) significant to the entity’s ability to continue producing outputs and is considered unique or scarce; or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

The proposed guidance is included as Application guidance and includes a diagram to explain how the guidance should be applied. Illustrative examples are also included to illustrate when the definition of a function is not met.</td></tr>
<tr><th colspan="2">Proposed transitional provisions</th></tr>
<tr><td>Transitional provisions</td><td>The Board proposes that the revised Standards of GRAP are applied prospectively to a transaction or event that involves a transfer or functions or merger that occurs after the adoption of the revised Standards.</td></tr>
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How to access information	
Access information on ED 204	Visit our website on www.asb.co.za to access the Invitation to Comment (ITC) and the revisions to GRAP 105, GRAP 106 and GRAP 107.

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