



ACCOUNTING STANDARDS BOARD

PROPOSED REVISION TO THE STANDARD OF GENERALLY RECOGNISED ACCOUNTING PRACTICE ON

TRANSFER OF FUNCTIONS BETWEEN ENTITIES NOT UNDER COMMON CONTROL (GRAP 106)

(ED 204)

Acknowledgement

The Standard of Generally Recognised Accounting Practice (GRAP) on *Transfer of Functions Between Entities Not Under Common Control* is based on the International Public Sector Accounting Standard (IPSAS) 40 on *Public Sector Combinations* from the *Handbook of International Public Sector Accounting Pronouncements* of the International Public Sector Accounting Standards Board (IPSASB), published by the International Federation of Accountants (IFAC) and is used with the permission of the IFAC.

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Introduction

This pronouncement is set out in paragraphs .01 to .128. All paragraphs in this pronouncement have equal authority. The status and authority of appendices are dealt with in the preamble to each appendix. This pronouncement should be read in the context of its objective, its basis for conclusions and/or the basis for conclusions of its international equivalent, if applicable, the *Preface to the Standards of GRAP* and the *Framework for the Preparation and Presentation of Financial Statements*¹.

Standards of GRAP and Interpretations of the Standards of GRAP should also be read in conjunction with any directives issued by the Board prescribing transitional provisions, as well as any regulations issued by the Minister of Finance regarding the effective dates of the Standards, published in the Government Gazette.

Directives should be read in conjunction with the applicable Standards of GRAP and Interpretations of the Standards of GRAP.

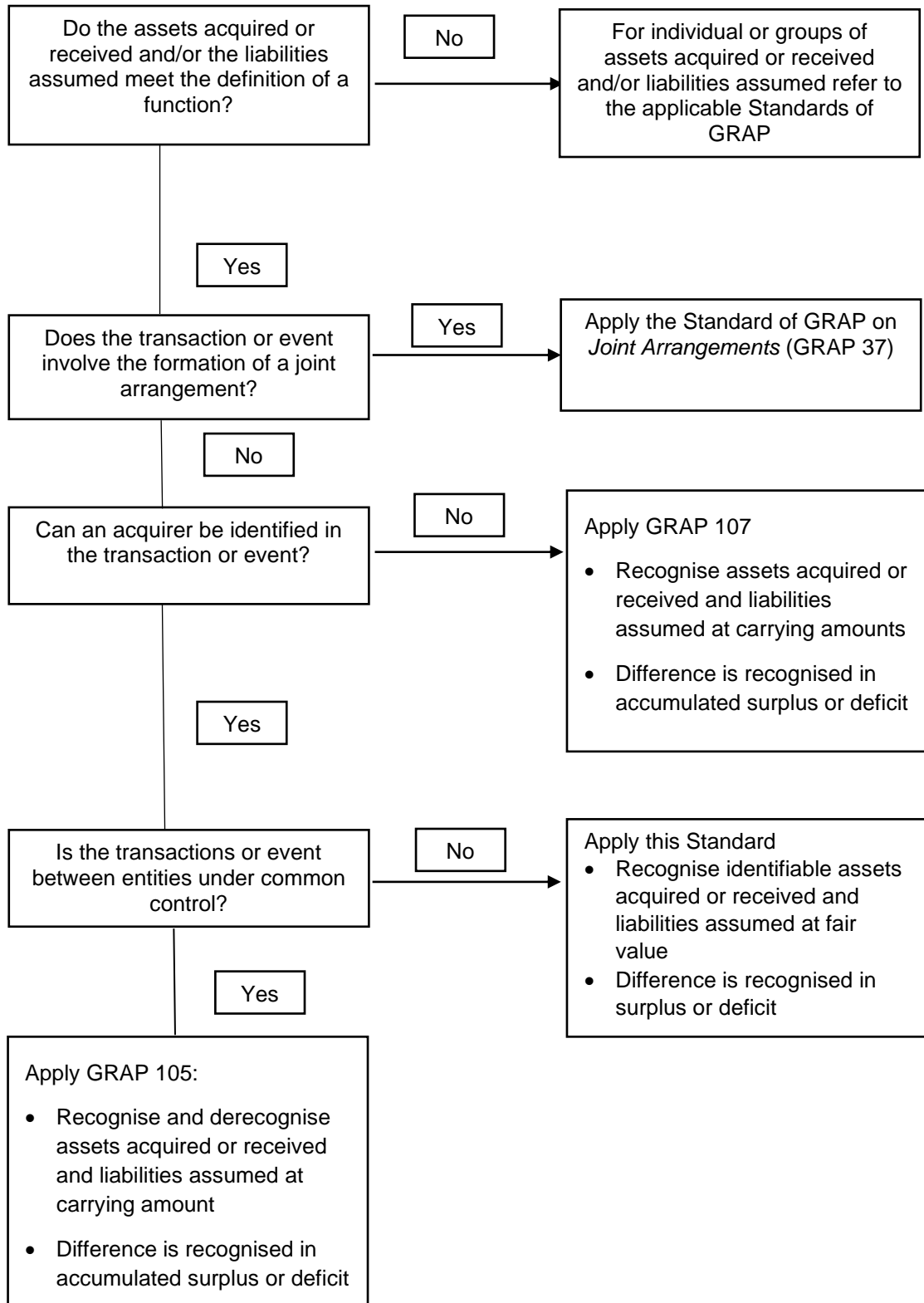
¹ In June 2017, the Board replaced the *Framework for the Preparation and Presentation of Financial Statements* with the *Conceptual Framework for General Purpose Financial Reporting*.

Objective

- .01 The objective of this Standard is to establish principles and requirements for the acquirer in a transfer of functions between entities not under common control and its effects.

Scope

- .02 ***An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for a transfer of functions between entities not under common control. This Standard does not apply to:***
- (a) ***the acquisition or receipt of an individual asset or a groups of assets (and/or any related liabilities) and/or a liability or a group of liabilities that do not constitute a function. In such cases an entity shall identify and recognise the individual identifiable asset or a group of assets (and any related liabilities), and/or a liability or group of liabilities assumed;***
 - (b) ***a transfer of functions between entities under common control (see the Standard of GRAP on Transfer of Functions Between Entities Under Common Control (GRAP 105));***
 - (c) ***a merger (see the Standard of GRAP on Mergers (GRAP 107)); and***
 - (d) ***the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.***
- .03 ***The requirements of this Standard do not apply to 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.***
- .04 A transfer of functions between entities not under common control could involve a transfer of another entity or transfer of part of another entity.
- .05 Entities should consider the following diagram in determining whether this Standard should be applied in accounting for a transaction or event that involves a transfer of functions or merger:



- .06 The acquisition or receipt of an individual asset or a group of assets (and any related liabilities), and/or the assumption of a liability or a group of liabilities are excluded from the scope of this Standard as these arrangements result in the acquisition or receipt of an asset or a group of assets (and any related liabilities) and/or the assumption of a liability or a group of liabilities by an entity rather than the transfer of functions. For example, when a national roads agency takes control of a provincial road from various provincial Departments, it is a transfer of individual assets.
- .07 If no acquirer can be identified in a transaction or event, GRAP 107 should be applied. A merger is the establishment of new combined entity in which none of the former entities obtains control over any other and no acquirer can be identified.
- .08 A transaction or event in which an acquirer can be identified, and that occurs between entities not under common control falls within the scope of this Standard. A transfer of functions between entities not under common control is a reorganisation and/or reallocation of functions between entities that are not ultimately controlled by the same entity both before and after the transfer of functions and that control is not transitory.
- .09 A transaction or event in which an acquirer can be identified and that results in a transfer of functions between entities under common control is excluded from the scope of this Standard. Such a transaction or event should be accounted for in terms of GRAP 105.

Definitions

- .10 ***The following terms are used in this Standard with the meanings specified:***

An acquiree is the entity that loses control of one or more functions that the acquirer obtains control of in a transfer of functions.

An acquirer is the entity that gains control of one or more functions in a transfer of functions.

Acquisition date is the date on which the acquirer obtains control of the acquiree.

A binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to the arrangement as if it were in the form of a contract. It includes rights from contracts or other legal rights.

Contingent consideration is usually, an obligation of the acquirer to transfer additional assets or a residual interest to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.

Control: An entity controls another entity when the entity is exposed, or has rights to variable benefits from its involvement with the other entity and has the ability to effect the nature and amount of those benefits through its power over the other entity.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

A **function** is an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purposes of achieving an entity's objectives, by providing goods and/or services or generating revenue.

An asset is **identifiable** if it either:

- (a) is separable, i.e. is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset and/or liability, regardless of whether the entity intends to do so; or
- (b) arises from rights arising from binding arrangements, but excluding rights granted by statute, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

A **merger** is the establishment of a new combined entity in which none of the former entities obtain control over any other and no acquirer can be identified.

Non-controlling interest is the interest in the net assets of a controlled entity not attributable, directly or indirectly, to a controlling entity.

Owners (for the purposes of this Standard), is used broadly to include holders of residual interests.

A **residual interest** is any contract that manifests an interest in the assets of an entity after deducting all of its liabilities. A residual interest includes contributions from owners, which may be shown as:

- (a) equity instruments or similar forms of unitised capital;
- (b) a formal designation of a transfer of resources (or a class of such transfers) by the parties to the transaction as forming part of an entity's net assets, either before the contribution occurs or at the time of the contribution; or
- (c) a formal agreement, in relation to the contribution, establishing or increasing an existing financial interest in the net assets of an entity.

A **transfer of functions** is the reorganisation and/or the re-allocation of

functions between entities by transferring functions between entities or into another entity.

Terms defined in other Standards of GRAP are used in this Standard with the same meaning as in those other Standards.

Binding arrangements

.11 Binding arrangements can be evidenced in several ways:

- (a) a contract concluded between the parties;
- (b) legislation, supporting regulations or similar means including, but not limited to, laws, regulation, policies, decisions concluded by authorities such as cabinet, executive committees, boards, municipal councils and ministerial orders; or
- (c) through the operation of law, including common law.

A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties.

Common control

.12 For a transaction or event to occur between entities under common control, the transaction or event needs to be between entities within the same sphere of government or between entities that are part of the same economic entity. Entities that are ultimately controlled by the same entity before and after the transfer of functions are within the same economic entity. For example, a national Health Department is mandated through legislation to transfer its primary school nutrition programme to the national Education Department. Because the national Education Department is identified as the acquirer, and both Departments are within the national sphere of government and within the same economic entity, the transfer of functions falls within the scope of GRAP 105.

.13 The extent of non-controlling interests in each of the entities that are involved in a transfer of functions before and after the transfer of functions is not relevant in determining whether the transaction or event involves entities under common control.

Function

.14 A function is an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purposes of achieving an entity's objectives by providing goods and/or services or generating revenue. Although a function usually has outputs, outputs are not required for an integrated set of activities and related assets and/or liabilities to qualify as a function. A function consists of inputs and processes applied to those inputs that have the ability to create outputs. A function can either be a part or a portion of an entity or can consist of the whole entity. For the purpose of this Standard, the three elements of a function are defined as follows:



- (a) **Input:** Any resource that creates outputs, or has the ability to contribute to the creation of outputs when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, and the ability to obtain access to necessary materials or rights and employees.
- (b) **Process:** Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates outputs or has the ability to contribute to the creation of outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but the intellectual capacity of an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.)
- (c) **Output:** The result of inputs and processes applied to achieve and improve efficiency of those inputs that provide goods and/or services or generate revenue. This may be in the form of achieving service delivery objectives, or the delivery of goods and/or services.

Optional test to identify concentration of fair value (see Appendix A paragraphs AG1 to AG10)

- .15 An entity may elect to apply an optional test (the concentration test) to assess if an acquired or received set of activities, assets and/or liabilities is a not a function. The concentration test is met if substantially all of the fair value of the gross assets acquired or received is concentrated in a single identifiable asset or group of similar identifiable assets (see Appendix A paragraph AG2). An entity may elect to apply the concentration test separately for each transaction or other event.
- .16 If the concentration test is not met, or if the entity elects not to perform the assessment, the requirements in paragraphs .17 to .20 should be applied to determine if the acquired or received set of activities and assets and/or liabilities are a function.

Elements of a function

- .17 Although functions usually have outputs, outputs are not required for an integrated set of activities and assets to qualify as a function. To be capable of being conducted and managed for the purposes identified in the definition of a function, an integrated set of activities and assets and/or liabilities requires two essential elements - inputs and processes applied to those inputs. A function need not include all of the inputs or processes that the acquiree used in operating that function. However, to be considered a function, an integrated set of activities and assets and/or liabilities must include, at a minimum, an input and a substantive

process that together significantly contribute to the ability to create output. Appendix A paragraphs AG8 to AG 10 provides guidance on how to assess whether a process is substantive.

- .18 If an acquired or received set of activities and assets and/or liabilities has outputs, continuation of revenue does not on its own indicate that both an input and substantive process have been acquired or received.
- .19 The nature of the elements of a function varies by sector and by the structure of an entity's operations (activities), including the entity's stage of development. Established functions often have many different types of inputs, processes and outputs, whereas new functions often have few inputs and processes and sometimes only a single output. Nearly all functions also have liabilities, but a function need not have liabilities. Furthermore, an acquired or received set of activities and assets that is not a function might have liabilities.
- .20 Determining whether a particular set of activities and assets and/or liabilities is a function should be based on whether the integrated set is capable of being conducted and managed as a function by another entity. Thus, in evaluating whether a particular set is a function, it is not relevant whether a transferor operated the set as a function or whether the acquirer intends to operate the set as a function.

Residual interest

- .21 A residual interest is a contract that shows evidence of an interest in the net assets of another entity. A residual interest entitles the holder of the interest to a part of the net assets of an entity, and any payments made to the holder are discretionary, e.g. dividends or similar distributions are paid to holders of residual interests at management's discretion.
- .22 In the public sector, various forms of contributed capital exist. For example, some public entities may issue shares, while others may have been given capital contributions through the budget process. Where an entity receives capital contributions other than through the issue of shares or other unitised capital, the following evidence may indicate that the contribution is a residual interest:
 - (a) there is a formal designation of the contribution by the parties to the transaction either before or at the time of the contribution; or
 - (b) there is a formal agreement between the parties specifying that the contribution represents a residual interest of another entity.

Even though a formal transfer of resources may be proven by a designation or formal agreement, an entity assesses the nature of the transfer based on its substance and not merely its legal form.

Identifying a transfer of functions between entities not

under common control

- .23** *An entity shall determine whether a transaction or other event is a transfer of functions between entities not under common control by applying the definition in this Standard, which requires that the assets acquired or received and/or liabilities assumed constitute a function. If the assets acquired or received and/or liabilities assumed do not constitute a function, the reporting entity shall account for the transaction or other event as in accordance with the applicable Standard of GRAP.*
- .24** This Standard defines a transfer of functions as the reorganisation and/or the re-allocation of functions between entities by transferring functions between entities or into another entity. The transfer of functions must be undertaken between entities not under common control. An acquirer might obtain control of an acquiree in a variety of ways, for example:
- (a) by transferring cash, cash equivalents or other assets (including net assets that constitute a function);
 - (b) by incurring liabilities;
 - (c) by exchanging residual interests;
 - (d) by providing more than one type of consideration; or
 - (e) without transferring consideration, including through a binding arrangement.
- .25** A transfer of functions between entities not under common control may be structured in a variety of ways, which include but are not limited to:
- (a) one or more functions become controlled entities of an acquirer or the net assets of one or more functions are legally acquired or received by the acquirer; or
 - (b) one entity transfers its net assets, or its owners transfer their residual interests, to another entity or its owners.

The acquisition method of accounting

- .26** *An entity shall account for each transfer of functions between entities not under common control by applying the acquisition method of accounting.*
- .27** Applying the acquisition method of accounting requires:
- (a) identifying the acquirer;
 - (b) determining the acquisition date;
 - (c) recognising and measuring the identifiable assets acquired or received, the liabilities assumed and any non-controlling interests in the acquiree; and
 - (d) recognising the difference between (c) and the consideration transferred to the

seller.

Identifying the acquirer

- .28** *For each transfer of functions between entities not under common control, the party that gains control of one or more functions shall be identified as the acquirer.*
- .29 The terms and conditions of a transfer of functions between entities not under common control are set out in a binding arrangement. In a transfer of functions, it is assumed that one of the parties to the transaction or event can be identified as the acquirer. The binding arrangement governing the terms and conditions of a transfer of functions may identify which entity to the transaction or event is the combining entities and which entity is the acquirer.
- .30 In a transfer of functions effected primarily by transferring cash or other assets (where applicable) and/or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets (where applicable), incurs the liabilities or transfers the non-controlling interests.
- .31 In a transfer of functions effected primarily by exchanging residual interests, the acquirer is the entity that does not experience a change in control.
- .32 In a transfer of functions involving more than one entity, one of the entities that existed before the transaction or event may be identified as the acquirer on the basis of available evidence available. For example, if the management of one of the entities involved in the transfer of functions dominates the selection of the management team in the newly establish entity, the dominant entity is usually the acquirer.
- .33 Determining the acquirer should include a consideration of, amongst other things, which of the combining entities initiated the transaction or event, the relative size of the combining entities, as well as whether the assets or revenue of one of the entities involved in the transaction or event significantly exceed those of the other entities. If no acquirer can be identified, the transaction or event should be accounted for in terms of GRAP 107.

Determining the acquisition date

- .34** *The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.*
- .35 The binding arrangement governing the terms and conditions of a transfer of functions between entities not under common control may specify that the transaction or event is effective from a specific date. The date on which the acquirer obtains control of one or more functions is generally the date on which the acquirer transfers the consideration (if any), and/or acquires or receive the assets, assumes the liabilities, and acquires or receives any non-controlling interests of the acquiree as identified to in the binding arrangement – closing date. However, the

acquirer may obtain control on a date that is either earlier or later than the closing date. For example, legislation passed in Parliament on 1 April 20X1 requires Department A to take over the functions of Department B. The Departments are not within the same economic entity as they are not within the same sphere of government. A directive is issued stating that the effective date of the transfer is 1 June 20X1. Department A however only obtains control of the assets and liabilities on 1 July 20X1 through a memorandum of understanding drawn up between the two Departments. As Department A can only use or otherwise benefit from the transfer of functions in pursuit of its objectives, or exclude or otherwise regulate the access of others to those benefits from 1 July 20X1, the transaction or event should be accounted for as from 1 July 20X1. An acquirer should consider all relevant facts and circumstances in identifying the acquisition date.

- .36 The fact that a binding arrangement exists creates an obligation for either one or both of the parties to act in order to fulfil the terms and conditions of the arrangement. This means that under the binding arrangement, the acquirer has an enforceable claim over the acquiree either, to relinquish control of the entity, or over the assets, liabilities and non-controlling interests of the function to be transferred.

Recognising the identifiable assets acquired or received, the liabilities assumed and any non-controlling interests in the acquiree

Recognition principle

- .37 As of the acquisition date, the acquirer shall recognise, the identifiable assets acquired or received, the liabilities assumed and any non-controlling interests in the acquiree. Recognition of identifiable assets acquired or received, liabilities assumed, and any non-controlling interests is subject to the conditions specified in paragraphs .38 to .40.**

Recognition conditions

- .38 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired or received and/or liabilities assumed must meet the definitions of assets or liabilities in the *Framework for the Preparation and Presentation of Financial Statements*¹ (the Conceptual Framework) and the recognition criteria in the applicable Standards of GRAP at the acquisition date. For example, costs the acquirer expects but is not obliged to incur in the future to effect its plan to exit an activity of an acquiree or to terminate the employment of or relocate an acquiree's employees are not liabilities at the acquisition date. Therefore, the acquirer does not recognise those costs as part of applying the acquisition method. Instead, the acquirer recognises those costs in its post-combination financial statements in accordance with other Standards of GRAP.
- .39 In addition, to qualify for recognition as part of applying the acquisition method, the identifiable assets acquired or received, liabilities assumed, and any non-controlling interests must be part of what the acquirer and the acquiree agreed in the binding

arrangement rather than the result of separate transactions. The acquirer should apply the guidance in paragraphs .99 to .105 to determine which assets acquired or received, liabilities assumed and any non-controlling interests are part of the transfer of functions for the acquiree and which, if any, are the result of separate transactions to be accounted for in accordance with their nature and the applicable Standards of GRAP.

- .40 The acquirer's application of the recognition principle and conditions may result in recognising some assets, liabilities and non-controlling interests that the acquiree had not previously recognised as assets, liabilities and non-controlling interests in its financial statements. For example, the acquirer recognises the acquired or received identifiable intangible assets, such as, a patent, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.
- .41 Paragraphs .42 to .48 provide guidance on recognising operating leases and intangible assets. Paragraphs .64 to .78 specify the types of identifiable assets and/or liabilities that include items for which this Standard provides limited exceptions to the recognition principle and conditions.

Operating leases

- .42 The acquirer should not recognise assets and/or liabilities related to an operating lease in which the acquiree is the lessee except as required by paragraphs .43 and .44.
- .43 The acquirer should determine whether the terms of each operating lease in which the acquiree is the lessee are favourable or unfavourable. The acquirer should recognise an intangible asset if the terms of an operating lease are favourable relative to market terms and a liability if the terms are unfavourable relative to market terms. Paragraph .59 provides guidance on measuring the acquisition-date fair value of assets subject to operating leases in which the acquiree is the lessor.
- .44 An identifiable intangible asset may be associated with an operating lease, which may be evidenced by market participants' willingness to pay a price for the lease even if it is at market terms.

Intangible assets

- .45 The acquirer should separately recognise the identifiable intangible assets acquired or received in a transfer of functions. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal right criterion.
- .46 An intangible asset that meets the contractual-legal right criterion is identifiable even if the asset is not transferable or separable from the acquiree or from other rights and obligations. For example:
 - (a) An acquiree leases a manufacturing facility under an operating lease that has terms that are favourable relative to market terms. The lease terms explicitly

prohibit transfer of the lease (through either sale or sublease). The amount by which the lease terms are favourable compared with the terms of current market transactions for the same or similar items is an intangible asset that meets the contractual-legal right criterion for separate recognition, even though the acquirer cannot sell or otherwise transfer the lease contract.

- (b) An acquiree owns and operates a power plant. The licence to operate that power plant is an intangible asset that meets the contractual-legal right criterion for separate recognition, even if the acquirer cannot sell or transfer it separately from the acquired or received power plant. An acquirer may recognise the fair value of the operating licence and the fair value of the power plant as a single asset for financial reporting purposes if the useful lives of those assets are similar.
- (c) An acquiree owns a technology patent. It has licensed that patent to others for their exclusive use outside the domestic market, receiving a specified percentage of future foreign revenue in exchange. Both the technology patent and the related licence agreement meet the contractual-legal right criterion for separate recognition separately even if selling or exchanging the patent and the related licence agreement separately from one another would not be practical.

.47 The separability criterion means that an acquired or received intangible asset is capable of being separated or divided from the acquiree and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, identifiable asset and/or liability. An intangible asset that the acquirer would be able to sell, licence or otherwise exchange for something else of value meets the separability criterion even if the acquirer does not intend to sell, licence or otherwise exchange it. An acquired or received intangible asset meets the separability criterion if there is evidence of exchange transactions for that type of asset or an asset of a similar type, even if those transactions are infrequent and regardless of whether the acquirer is involved in them. For example, lists of users of a service are frequently licenced and thus meet the separability criterion. Even if an acquiree believes its lists of users of a service have characteristics different from other lists, the fact that lists of users of a service are frequently licenced generally means that the transferred list of users of a service meets the separability criterion. However, a list of users of a service acquired or received in a transfer of functions would not meet the separability criterion if the terms of confidentiality or other agreements prohibit an entity from selling, leasing or otherwise exchanging information about its users of a service.

.48 An intangible asset that is not individually separable from the acquiree meets the separability criterion if it is separable in the transfer of functions with a related contract, identifiable asset and/or liability. For example:

- (a) Market participants exchange deposit liabilities and related depositor

relationship intangible assets in observable exchange transactions. Therefore, the acquirer should recognise the depositor relationship intangible asset separately.

- (b) An acquiree owns a registered trademark and documented but unpatented technical expertise used to manufacture the trademarked product. To transfer ownership of a trademark, the owner is also required to transfer everything else necessary for the new owner to produce a product or service indistinguishable from that produced by the former owner. Because the unpatented technical expertise must be separated from the acquiree and sold if the related trademark is sold, it meets the separability criterion.

Assembled workforce and other items that are not identifiable

- .49 The acquirer subsumes into the calculation of the resulting excess the value of an acquired or received intangible asset that is not identifiable as of the acquisition date. For example, an acquirer may attribute value to the existence of an assembled workforce, which is an existing collection of employees that permits the acquirer to continue to operate from the acquisition date. An assembled workforce does not represent the intellectual capital of the skilled workforce—the (often specialised) knowledge and experience that employees of an acquiree bring to their jobs. Because the assembled workforce is not an identifiable asset to be recognised separately from resulting excess, any value attributed to it is subsumed into calculation of the resulting excess.
- .50 The acquirer also subsumes into the resulting excess any value attributed to items that do not qualify as assets at the acquisition date. For example, the acquirer might attribute value to potential binding arrangements the acquiree is negotiating at the acquisition date. Because those potential binding arrangements are not themselves assets at the acquisition date, the acquirer does not recognise them separately from the resulting excess. The acquirer should not subsequently reclassify the value of those binding arrangements from the resulting excess for events that occur after the acquisition date. However, the acquirer should assess the facts and circumstances surrounding events occurring shortly after the transfer of functions to determine whether a separately recognisable intangible asset existed at the acquisition date.
- .51 After initial recognition, an acquirer accounts for intangible assets acquired or received in a transfer of functions in accordance with the provisions of GRAP 31. However, as described in paragraph .04 of GRAP 31, the accounting for some acquired or received intangible assets after initial recognition is prescribed by other Standards of GRAP.
- .52 The identifiability criteria determine whether an intangible asset is recognised separately from the resulting excess. However, the criteria neither provide guidance for measuring the fair value of an intangible asset nor restrict the assumptions used in measuring the fair value of an intangible asset. For example, the acquirer would

take into account the assumptions that market participants would use when pricing the intangible asset, such as expectations of future renewals of binding arrangements, in measuring fair value. It is not necessary for the renewals themselves to meet the identifiability criteria. (However, see paragraph .43, which establishes an exception to the fair value measurement principle for reacquired rights recognised in a transfer of functions.)

Classifying or designating identifiable assets acquired or received liabilities assumed or any non-controlling interests in a transfer of functions

.53 At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired or received, liabilities assumed or any non-controlling interests as necessary to subsequently apply other Standards of GRAP subsequent to the acquisition date. The acquirer shall make those classifications or designations on the basis of the terms of the binding arrangement, economic conditions, its operating or accounting policies and other relevant conditions as they exist at the acquisition date.

.54 In some situations, Standards of GRAP provide for different accounting depending on how an entity classifies or designates a particular asset and/or liability. Examples of classifications or designations that the acquirer should make on the basis of the relevant conditions as they exist at the acquisition date include but are not limited to:

- (a) classification of particular financial assets and/or liabilities as a financial asset and/or liability at fair value or amortised cost in accordance with the Standard of GRAP on *Financial Instruments* (GRAP 104);
- (b) assessment of whether an embedded derivative should be separated from the host contract in accordance with GRAP 104.

.55 This Standard provides two exceptions to the principle in paragraph .54:

- (a) classification of a lease contract as either an operating lease or a finance lease in accordance with the Standard of GRAP on *Leases*; and
- (b) classification of a contract as an insurance contract in accordance with the International Financial Reporting Standard(s) (IFRS® Standard(s)) on insurance.

The acquirer should classify those contracts on the basis of the terms and other factors at the inception of the contract (or, if the terms of the contract have been modified in a manner that would change its classification, at the date of that modification, which might be the acquisition date).

Measurement principle

.56 The acquirer shall measure the identifiable assets acquired or received, and the liabilities assumed and non-controlling interests at their acquisition-date fair values.

- .57 For each transfer of functions, the acquirer should measure at the acquisition date components of non-controlling interests in the acquiree that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation at either:
- (a) fair value; or
 - (b) the present ownership instruments' proportionate share in the recognised amounts of the acquiree's identifiable net assets.

All other components of non-controlling interests should be measured at their acquisition-date fair values, unless another measurement basis is required by the Standards of GRAP.

Measuring the fair value of particular identifiable assets and non-controlling interests in an acquiree in a transfer of functions

Assets with uncertain cash flows (valuation allowances)

- .58 The acquirer should not recognise a separate valuation allowance as of the acquisition date for assets acquired or received in a transfer of functions that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure. For example, because this Standard requires the acquirer to measure acquired or received receivables, including loans, at their acquisition-date fair values in accounting for a transfer of functions, the acquirer does not recognise a separate valuation allowance for the cash flows of the binding arrangement that are deemed to be uncollectible at that date.

Assets subject to operating leases in which the acquiree is the lessor

- .59 In measuring the acquisition-date fair value of an asset such as a building or a patent that is subject to an operating lease in which the acquiree is the lessor, the acquirer should take into account the terms of the lease. In other words, the acquirer does not recognise a separate asset and/or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms as paragraph .43 requires for leases in which the acquiree is the lessor.

Assets that the acquirer intends not to use or to use in a way that is different from the way other market participants would use them

- .60 For security or other reasons, the acquirer may intend not to use an acquired or received non-financial asset actively. For example, that might be the case for an acquired or received research and development intangible asset that the acquirer plans to use defensively by preventing others from using it. Nevertheless, the acquirer should measure the fair value of the non-financial asset, both initially and when measuring fair value less costs of disposal for subsequent impairment testing.

Non-controlling interests in an acquiree

- .61 This Standard allows the acquirer to measure a non-controlling interest in the acquiree at its fair value at the acquisition date. The acquirer should measure the fair value of the non-controlling interest using valuation techniques, unless a quoted price can be obtained for any equity shares in an active market. In these instances, the acquirer should determine the acquisition-date fair value of a non-controlling interest with reference to the quoted price in an active market for the equity shares (i.e., those not held by the acquirer).
- .62 Paragraphs .64 to .78 specify the types of identifiable assets and/or liabilities that include items for which this Standard provides limited exceptions to the recognition or measurement principle.

Exceptions to the recognition or measurement principles

- .63 This Standard provides limited exceptions to its recognition and measurement principles. Paragraphs .64 to .78 specify both the particular items for which exceptions are provided and the nature of those exceptions. The acquirer should account for those items by applying the requirements in paragraphs .64 to .78, which will result in some items being:
- (a) Recognised either by applying recognition conditions in addition to those in paragraphs .38 and .39 or by applying the requirements of other Standards of GRAP, with results that differ from applying the recognition principle and conditions.
 - (b) Measured at an amount other than their acquisition-date fair values.

Exceptions to the recognition principles

Contingent liabilities and contingent assets

- .64 GRAP 19 defines a contingent liability as:
- (a) a possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
 - (b) a present obligation that arises from past events but is not recognised because:
 - (i) it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
 - (ii) the amount of the obligation cannot be measured with sufficient reliability.
- .65 The acquirer should recognise as of the acquisition date a contingent liability assumed in a transfer of functions if it is a present obligation that arises from past events and its fair value can be measured reliably. Therefore, contrary to GRAP 19 paragraphs .21(b), .30, .34, .36 and .37, the acquirer recognises a contingent

liability assumed in a transfer of functions where consideration is transferred at the acquisition date even if it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation. Paragraph .108 of this Standard provides guidance on the subsequent accounting for contingent liabilities.

- .66 GRAP 19 defines a contingent asset as ‘a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity’. The acquirer should not recognise a contingent asset at the acquisition date.

Liabilities and contingent liabilities within the scope of the Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* (GRAP 19) or the Interpretation of the Standard of GRAP on *Liabilities to Pay Levies* (IGRAP 19)

.67 Paragraph .68 applies to liabilities and contingent liabilities that would be within the scope of GRAP 19 or IGRAP 19 if they were incurred separately rather than assumed in a transfer of functions.

.68 The Conceptual Framework defines a liability as ‘a present obligation of the entity for an outflow of resources that results from a past event’. For a provision or contingent liability that would be within the scope of GRAP 19, the acquirer shall apply GRAP 19 paragraphs .22 to .29 to determine whether at the acquisition date a present obligation exists as a result of past events. For a levy that would be within the scope of IGRAP 19, the acquirer shall apply the Interpretation to determine whether the obligating event that gives rise to a liability to pay the levy has occurred by the acquisition date.

.69 A present obligation identified in accordance with paragraph .68 might meet the definition of a contingent liability set out in paragraph .64(b). If so, paragraph .65 applies to that contingent liability.

Transfers, concessionary loans and similar benefits received by an acquirer or acquiree on the basis of criteria that may change as a result of a transfer of functions

- .70 A transfer, concessionary loan or similar benefit, previously received by an acquirer or an acquiree on the basis of criteria that change as a result of a transfer of functions, should be reassessed prospectively in accordance with other Standards of GRAP.

Income taxes (where included in the terms of the transfer of functions)

- .71 Transfer of functions by an entity may result in a tax authority forgiving amounts of tax due as part of the terms of the transfer of functions. The acquirer should not recognise any taxation items that are forgiven as a result of the terms of the transfer of functions.

- .72 The acquirer should recognise and measure any remaining taxation items included in or arising from a transfer of functions in accordance with the International Accounting Standard® on *Income Taxes*. The acquirer entity should recognise and measure any remaining revenue from taxation included in or arising from a transfer of functions in accordance with the Standard of *Revenue from Non-exchange Transactions (Taxes and Transfers)* (GRAP 23).

Forgiveness of amounts of tax due in a transfer of functions (where included in the terms of the transfer of functions)

- .73 The acquirer should not recognise any amounts in respect of an acquiree's tax due where these amounts have been forgiven by a tax authority as part of the terms of the transfer of functions. Where tax forgiveness occurs subsequent to a transfer of functions, the acquirer applies the requirements in paragraph .114. The acquirer should account for an acquiree's tax due that has not been forgiven by a tax authority in accordance with the International Accounting Standard® on *Income Taxes*.
- .74 If the acquirer is itself the tax authority, it should derecognise any tax receivable relating to the acquiree's tax due that has been forgiven in accordance with GRAP 23.
- .75 If, as a consequence of the terms of a transfer of functions, a tax authority forgives an amount of the acquirer's tax due, the acquirer should derecognise those amounts in accordance with the International Accounting Standard® on *Income Taxes*.

Exceptions to both the recognition and measurement principles

Employee benefits

- .76 The acquirer should recognise and measure a liability and/or an asset related to the acquiree's employee benefit arrangements in accordance with the Standard of GRAP on *Employee Benefits*.

Indemnification assets

- .77 The seller in a transfer of functions may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset and/or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer should recognise an indemnification asset at the same time that it recognises the indemnified item measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. Therefore, if the indemnification relates to an asset and/or a liability that is recognised at the acquisition date and measured at its acquisition-date fair value,

the acquirer should recognise the indemnification asset at the acquisition date measured at its acquisition-date fair value. For an indemnification asset measured at fair value, the effects of uncertainty about future cash flows because of collectability considerations are included in the fair value measure and a separate valuation allowance is not necessary (paragraph .58 provides related guidance).

- .78 In some circumstances, the indemnification may relate to an asset and/or a liability that is an exception to the recognition or measurement principles. For example, an indemnification may relate to a contingent liability that is not recognised at the acquisition date because its fair value is not reliably measurable at that date. Alternatively, an indemnification may relate to an asset and/or a liability, for example, one that results from an employee benefit that is measured on a basis other than acquisition-date fair value. In those circumstances, the indemnification asset should be recognised and measured using assumptions consistent with those used to measure the indemnified item, subject to management's assessment of the collectability of the indemnification asset and any contractual limitations on the indemnified amount. Paragraph .109 provides guidance on the subsequent accounting for an indemnification asset.

Exceptions to the measurement principle

Reacquired rights

- .79 The acquirer should measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining contractual term of the binding arrangement regardless of whether market participants would consider potential renewals of the binding arrangement when measuring fair value. Paragraphs .80 and .81 provide related guidance.
- .80 As part of a transfer of functions, an acquirer may reacquire a right that it had previously granted to the acquiree to use one or more of the acquirer's recognised or unrecognised assets. Examples of such rights include a right to use the acquirer's technology under a technology licencing agreement. A reacquired right is an intangible asset that the acquirer recognises separately from the difference between the identifiable assets acquired and liabilities assumed and the consideration transferred (if any). Paragraph .79 provides guidance on measuring a reacquired right and paragraph .107 provides guidance on the subsequent accounting for a reacquired right.
- .81 If the terms of the binding arrangement giving rise to a reacquired right are favourable or unfavourable relative to the terms of current market transactions for the same or similar items, the acquirer should recognise a settlement gain or loss. Paragraph .103 provides guidance for measuring that settlement gain or loss.

Recognising and measuring the difference between the assets acquired or received, liabilities assumed, any non-controlling interests and the consideration transferred (if any)

.82 The acquirer shall recognise the difference between the assets acquired or received, liabilities assumed any non-controlling interests and the consideration transferred (if any) as of the acquisition date in surplus or deficit. This difference is measured as the excess of (a) over (b) below:

(a) The aggregate of:

- (i) the consideration transferred (if any) measured in accordance with this Standard, which generally requires acquisition-date fair value (see paragraph .87);**
- (ii) the amount of any non-controlling interest in the acquiree measured in accordance with this Standard; and**
- (iii) in a transfer of functions achieved in stages (see paragraphs .91 and .92), the acquisition-date fair value of the acquirer's previously held residual interest in the acquiree.**

(b) The net of the acquisition-date amounts of the identifiable assets acquired or received, liabilities assumed and any non-controlling interests measured in accordance with this Standard.

.83 In a transfer of functions in which the acquirer and the acquiree exchange only residual interests, the acquisition-date fair value of the acquiree's residual interests may be more reliably measurable than the acquisition-date fair value of the acquirer's residual interests. If so, the acquirer should determine the resulting excess by using the acquisition-date fair value of the acquiree's residual interests instead of the acquisition-date fair value of the residual interests transferred. To determine the resulting excess in a transfer of functions in which no consideration is transferred, the acquirer should use the acquisition-date fair value of the acquirer's interest in the acquiree in place of the acquisition-date fair value of the consideration transferred (paragraph .82(a)(i)).

Measuring the acquisition-date fair value's of the acquirer's interest in the acquiree using valuation techniques

.84 In a transfer of functions achieved without the transfer of consideration, the acquirer must substitute the acquisition-date fair value of its interest in the acquiree for the acquisition-date fair value of the consideration transferred to measure the resulting excess (see paragraphs .82 and .83).

A non-exchange transfer without the transfer of consideration

.85 An entity often obtains control of a function in a non-exchange transaction in which it transfers no consideration. Such circumstances include, but are not limited to:

- (a) the transfer of a function to the entity by a donor for no consideration. Such transfers may take the form of a bequest; and
- (b) the transfer of a function to the entity where the function has net liabilities. The

entity may accept the acquisition or receipt of net liabilities to prevent the cessation of the function.

- .86 The acquirer that obtains control of an acquiree in a non-exchange transaction in which it transfers no consideration recognises a surplus or deficit in accordance with paragraph .82.

Consideration transferred

- .87 The consideration transferred in a transfer of functions should be measured at fair value, which should be calculated as the sum of the acquisition-date fair values of the assets acquired or received by the acquirer, the liabilities incurred by the acquirer, any non-controlling interests. Examples of potential forms of consideration include cash, other assets, a function or a controlled entity of the acquirer, contingent consideration, equity instruments, options, warrants and other owner interests.
- .88 The consideration transferred may include assets, liabilities, and non-controlling interests of the acquirer that have carrying amounts that differ from their fair values at the acquisition date (for example, non-monetary assets or a function of the acquirer). If so, the acquirer should remeasure the transferred assets, liabilities, and non-controlling interests to their fair values as of the acquisition date and recognise the resulting gains or losses, if any, in surplus or deficit. However, sometimes the transferred assets, liabilities and non-controlling interests remain within the new entity after the transfer of function (for example, because the assets, liabilities and non-controlling interests were transferred to the acquiree rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer should measure those assets, liabilities and non-controlling interests at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss in surplus or deficit on assets, liabilities and non-controlling interests it controls both before and after the transfer of functions.

Contingent consideration

- .89 The consideration the acquirer transfers in exchange for the acquiree includes any assets, liabilities and non-controlling interests resulting from a contingent consideration arrangement (see paragraph .87). The acquirer should recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.
- .90 The acquirer should classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as net assets on the basis of the definitions of a residual interest and a financial liability in GRAP 104. The acquirer should classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph .113 provides guidance on the subsequent accounting for contingent consideration.

A transfer of functions achieved in stages

- .91 An acquirer sometimes obtains control of an acquiree in which it held a residual interest immediately before the acquisition date. For example, on 31 March 20X1, Entity A holds a 35 per cent non-controlling interest in Entity B. On that date, Entity A purchases an additional 40 per cent interest in Entity B, which gives it control of Entity B. This Standard refers to such a transaction as a transfer of functions achieved in stages, sometimes also referred to as a step transfer of functions.
- .92 In a transfer of functions achieved in stages, the acquirer should remeasure its previously held residual interest in the acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in surplus or deficit. In prior reporting periods, the acquirer may have recognised changes in the value of its residual interest in the acquiree in surplus or deficit. If so, the amount that was recognised in surplus or deficit should be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held residual interest.

Measurement period

- .93 ***If the initial accounting for a transfer of functions is incomplete by the end of the reporting period in which the transfer occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date. During the measurement period, the acquirer shall also recognise additional assets, or liabilities and any non-controlling interests if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets, or liabilities and any non-controlling interests as of that date. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed two years from the acquisition date.***
- .94 The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a transfer of functions. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the assets, liabilities and non-controlling interests as of the acquisition date in accordance with the requirements of this Standard:
- (a) the identifiable assets acquired or received, liabilities assumed and any non-controlling interests in the acquiree;
 - (b) the consideration transferred, if any, for the acquiree;

- (c) in a transfer of functions achieved in stages, the interest in the acquiree previously held by the acquirer; and
- (d) the resulting excess of the purchase consideration paid (if any) over the fair value of the assets received, liabilities assumed or non-controlling interests acquired or received.

The information necessary to identify and measure the identifiable assets, liabilities and any non-controlling interests in the acquiree will generally be available at the acquisition date. However, this may not be the case where the acquiree has previously prepared their financial statements using different accounting policies.

- .95 The acquirer should consider all relevant factors in determining whether information obtained after the acquisition date should result in an adjustment to the provisional amounts recognised or whether that information results from events that occurred after the acquisition date. Relevant factors include the date when additional information is obtained and whether the acquirer can identify a reason for a change to provisional amounts. Information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date than is information obtained several months later. For example, unless an intervening event that changed its fair value can be identified, the sale of an asset to a third party shortly after the acquisition date for an amount that differs significantly from its provisional fair value determined at that date is likely to indicate an error in the provisional amount.
- .96 The acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset, liability and any non-controlling interests by means of decreasing (increasing) the excess of the purchase consideration paid (if any) over the fair value of the assets acquired or received, liabilities assumed and any non-controlling interests previously recognised in surplus or deficit. However, new information obtained during the measurement period may sometimes result in an adjustment to the provisional amount of more than one asset, liability and any non-controlling interests. For example, the acquirer might have assumed a liability to pay damages related to an accident in one of the acquiree's facilities, part or all of which are covered by the acquiree's liability insurance policy. If the acquirer obtains new information during the measurement period about the acquisition-date fair value of that liability, the adjustment to the resulting excess resulting from a change to the provisional amount recognised for the liability would be offset (in whole or in part) by a corresponding adjustment to the previously recognised excess in surplus or deficit resulting from a change to the provisional amount recognised for the claim receivable from the insurer.
- .97 During the measurement period, the acquirer should recognise adjustments to the provisional amounts as if the accounting for the transfer of functions had been completed at the acquisition date. Thus, the acquirer should revise comparative information for prior periods presented in financial statements as needed, including

making any change in depreciation, amortisation or other income effects recognised in completing the initial accounting.

- .98 After the measurement period ends, the acquirer should revise the accounting for a transfer of functions only to correct an error in accordance with the Standard of GRAP on *Accounting Policies, Changes in Accounting Estimates and Errors* (GRAP 3).

Determining what is part of the transfer of functions transaction

- .99 *The acquirer and the acquiree may have a pre-existing relationship or other relationship before or when negotiations for the transfer of functions began, or they may enter into a binding arrangement during the negotiations that is separate from the transfer of functions, i.e., amounts that are not part of that transferred by the acquiree. In either situation, the acquirer shall identify any amounts that are not part of what the acquirer and the acquiree exchanged in the transfer of functions. The acquirer shall apply this Standard only to the consideration transferred (if any) and the assets acquired or received, and liabilities assumed and any non-controlling interests acquired or received by the acquirer in the transfer of functions as governed by the terms and conditions of the binding arrangement. Apart from the transactions identified in paragraphs .102 and .103, separate transactions shall be accounted for in accordance with the applicable Standards of GRAP.***

- .100 A transaction entered into by or on behalf of the acquirer or primarily for the benefit of the acquirer, rather than primarily for the benefit of the acquiree before the transfer of functions, is likely to be a separate transaction. The following are examples of separate transactions that are not to be included in applying the acquisition method:

- (a) a transaction that in effect settles pre-existing relationships between the acquirer and acquiree;
- (b) a transaction that reimburses the acquiree or its former owners for paying the acquirer's acquisition-related costs; and
- (c) contributions received from third parties as compensation for future services as a result of undertaking a transfer of functions.

Paragraphs .101 to .104 provide related guidance.

- .101 The acquirer should consider the following factors, which are neither mutually exclusive nor individually conclusive, to determine whether a transaction is part of the transfer of functions or whether the transaction is separate from the transfer of functions:

- (a) **The reasons for the transaction** — Understanding the reasons why the parties to the transfer of functions entered into a particular transaction or arrangement may provide insight into whether it is part of the consideration

transferred, if any, and the assets acquired, received or transferred and/or liabilities assumed or relinquished. For example, if a transaction is arranged primarily for the benefit of the acquirer rather than primarily for the benefit of the acquiree before the transfer of function, that portion of the consideration (and any related assets and/or liabilities) is less likely to be part of the exchange of the acquiree. Accordingly, the acquirer would account for that portion separately from the transfer.

- (b) **Who initiated the transaction** – Understanding who initiated the transaction may also provide insight into whether it is part of the exchange for the acquiree. For example, a transaction or other event that is initiated by the acquirer may be entered into for the purpose of providing future economic benefits or service potential to the acquirer with little or no benefit received by the acquiree before the transfer of functions. On the other hand, a transaction or arrangement initiated by the acquiree is less likely to be for the benefit of the acquirer and more likely to be part of the transfer of functions transaction.
- (c) **The timing of the transaction** — The timing of the transaction may also provide insight into whether it is part of the transfer of functions. For example, a transaction between the acquirer and acquiree that takes place during the negotiations of the terms of the transfer of functions may have been entered into in contemplation of the transfer of functions to provide future economic benefits or service potential to the acquirer. If so, the acquiree or its former owners before the transfer of functions are likely to receive little or no benefit from the transaction except for benefits they receive as part of the transfer of functions.

Effective settlement of a pre-existing relationship between the acquirer and acquiree in a transfer of functions (application of paragraph .100(a))

- .102 The acquirer and acquiree may have a relationship that existed before they contemplated the transfer of functions, referred to here as a ‘pre-existing relationship’. A pre-existing relationship between the acquirer and acquiree may be contractual (for example, vendor or supplier) or non-contractual (for example, plaintiff and defendant).
- .103 If the transfer of functions in effect settles a pre-existing relationship, the acquirer recognises a gain or loss, measured as follows:
 - (a) for a pre-existing non-contractual relationship (such as a lawsuit), fair value.
 - (b) for a pre-existing contractual relationship, the lesser of (i) and (ii):
 - (i) The amount by which the binding arrangement is favourable or unfavourable from the perspective of the acquirer when compared with terms for current market transactions for the same or similar items. (An unfavourable contract is a contract that is unfavourable in terms of current

market terms. It is not necessarily an onerous contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.)

- (ii) The amount of any stated settlement provisions in the binding arrangement available to the counterparty to whom the binding arrangement is unfavourable.

If (ii) is less than (i), the difference is included as part of the transfer of functions accounting. The amount of gain or loss recognised may depend in part on whether the acquirer had previously recognised a related asset and/or liability, and the reported gain or loss therefore may differ from the amount calculated by applying the above requirements.

- .104 A pre-existing relationship may be a contract that the acquirer recognises as a reacquired right. If the binding arrangement includes terms that are favourable or unfavourable when compared with pricing for current market transactions for the same or similar items, the acquirer recognises, separately from the transfer of functions, a gain or loss for the effective settlement of the contract, measured in accordance with paragraph .103.

Acquisition-related costs

- .105 Acquisition-related costs are costs the acquirer incurs to effect a transfer of functions. Those costs include finders fees, advisory, legal, accounting, valuation and other professional or consulting fees, general administrative costs including the costs of maintaining an internal acquisitions department, and any costs of registering and issuing debt and equity securities. The acquirer should account for acquisition-related costs as expenses in the periods in which the costs are incurred and the services are received, with one exception. The costs to issue debt or equity securities (if applicable) should be recognised in accordance with GRAP 104.

Subsequent measurement and accounting

- .106 *In general, an acquirer shall subsequently measure and account for assets acquired or received, liabilities assumed or incurred and the residual interest issued in a transfer of functions in accordance with other applicable Standards of GRAP for those items, depending on their nature. However, this Standard provides guidance on subsequently measuring and accounting for the following assets acquired or received, liabilities assumed or incurred and residual interest issued in a transfer of functions:***
- (a) *reacquired rights;***
 - (b) *contingent liabilities recognised as of the acquisition date;***
 - (c) *indemnification assets; and***

- (d) ***contingent consideration;***
- (e) ***transfers, concessionary loans and similar benefits acquired or received by an acquirer or acquiree on the basis of criteria that may change as a result of a transfer of functions; and***
- (f) ***income taxes (where not included in the terms of the transfer of functions).***

Reacquired rights

- .107 A reacquired right recognised as an intangible asset should be amortised over the remaining period of the contract in which the right was granted, where the right was granted for a finite period. Where the right was granted for an indefinite period, the acquirer should test the right for impairment at least annually, and whenever there is an indication that the right may be impaired. An acquirer that subsequently sells a reacquired right to a third party should include the carrying amount of the intangible asset in determining the gain or loss on the sale.

Contingent liabilities

- .108 After initial recognition and until the liability is settled, cancelled or expires, the acquirer should measure a contingent liability recognised in a transfer of functions at the higher of:
- (a) the amount that would be recognised in accordance with GRAP 19; and
 - (b) the amount initially recognised less, if appropriate, cumulative amortisation recognised in accordance with the Standard of GRAP on *Revenue from Exchange Transactions*.

This requirement does not apply to contracts accounted for in accordance with GRAP 104.

Indemnification assets

- .109 At the end of each subsequent reporting period, the acquirer should measure an indemnification asset that was recognised at the acquisition date on the same basis as the indemnified liability and/or asset, subject to any limitations as set in the binding arrangement on its amount and, for an indemnification asset that is not subsequently measured at its fair value, management's assessment of the collectability of the indemnification asset. The acquirer should derecognise the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.

Transfers, concessionary loans and similar benefits acquired or received by an acquirer or acquiree on the basis of criteria that may change as a result of a transfer of functions

- .110 Prior to a transfer of functions taking place, an acquirer or an acquiree may acquire or receive a transfer from a third party, based on specified criteria. For example, a national government may provide grants to those municipalities where the municipality's revenue per head of population is below a threshold. A transfer of functions by a municipality of a cash-generating operation may increase the revenue per head of population of the municipality so that it is above the threshold. This may cause the government to review the grant.
- .111 The acquirer should not account for any revisions to the grant amount as part of the transfer of functions, but accounts for any revisions at the point the grantor makes its intentions known in accordance with other Standards of GRAP.
- .112 Similar circumstances may arise in respect of concessionary loans and other benefits. The acquirer should not account for any revisions to those transactions as part of the transfer of functions, but accounts for any revisions at the point the grantor makes its intentions known in accordance with other Standards of GRAP.

Contingent consideration

- .113 Some changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date. Such changes are measurement period adjustments in accordance with paragraphs .93 to .97. However, changes resulting from events after the acquisition date, such as meeting a performance target, or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer should account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:
- (a) Contingent consideration classified as net assets should not be remeasured and its subsequent settlement should be accounted for within net assets.
 - (b) Other contingent consideration that:
 - (i) is within the scope of GRAP 104 should be measured at fair value at each reporting period and changes in fair value should be recognised in surplus or deficit in accordance with that Standard of GRAP.
 - (ii) is not within the scope of GRAP 104 shall be measured at fair value at each reporting period and changes in fair value shall be recognised in surplus or deficit.

Income taxes (where not included in the terms of the transfer of functions)

- .114 Transfer of functions involving public sector entities may result in a tax authority

forgiving amounts of tax subsequent to the transfer of functions. The acquirer should account for the tax forgiven prospectively in accordance with the International Accounting Standard® on *Income Taxes*.

- .115 Examples of other Standards of GRAP that provide guidance on subsequently measuring and accounting for assets received and liabilities assumed or incurred in a transfer of functions include:
- (a) GRAP 31 prescribes the accounting for identifiable intangible assets acquired or received in a transfer of functions.
 - (b) The IFRS Standard(s) on insurance provides guidance on the subsequent accounting for an insurance contract acquired or received in a transfer of functions.
 - (c) The Standard of GRAP on *Consolidated Financial Statements* (GRAP 35) provides guidance on accounting for changes in a controlling entity's ownership interest in a controlled entity after control is obtained.
- .116 An acquirer should refer to the relevant International Standard(s) for guidance on subsequently measuring and accounting for insurance contracts and the International Accounting Standard® on *Income Taxes*.

Disclosures

- .117 *The acquirer shall disclose information that enables users of its financial statements to evaluate the nature and financial effect of a transfer of functions that occurs either:***
- (a) *during the current reporting period; or***
 - (b) *after the end of the reporting period but before the financial statements are authorised for issue.***
- .118 To meet the objective in paragraph .117, the acquirer shall disclose the following information for each transfer of functions that occurs during the reporting period:
- (a) The name and a description of the acquiree.
 - (b) The acquisition date.
 - (c) The percentage of voting rights acquired through a residual interest.
 - (d) The primary reasons for the transfer of functions and a description of how the acquirer obtained control of the acquiree, including, where applicable, the legal basis for the transfer of functions.
 - (e) The acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration, such as:
 - (i) cash;
 - (ii) other tangible or intangible assets, including a function or controlled entity

of the acquirer;

- (iii) liabilities incurred, for example, a liability for contingent consideration; and
 - (iv) residual interests of the acquirer, including the number of instruments or interests issued or issuable and the method of measuring the fair value of those instruments or interests.
- (f) For contingent consideration arrangements and indemnification assets:
- (i) the amount recognised as of the acquisition date;
 - (ii) a description of the arrangement and the basis for determining the amount of the payment; and
 - (iii) an estimate of the range of outcomes (undiscounted) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated. If the maximum amount of the payment is unlimited, the acquirer shall disclose that fact.
- (g) For acquired or received receivables:
- (i) the fair value of the receivables;
 - (ii) the gross contractual amounts receivable; and
 - (iii) the best estimate at the acquisition date of the contractual cash flows not expected to be collected.
- The disclosures shall be provided by major class of receivable, such as loans, direct finance leases and any other class of receivables.
- (h) The amounts recognised as of the acquisition date for each major class of assets acquired or received, liabilities assumed and non-controlling interests.
- (i) For each contingent liability recognised in accordance with paragraph .65, the information required in paragraph .99 of GRAP 19. If a contingent liability is not recognised because its fair value cannot be measured reliably, the acquirer shall disclose:
- (i) the information required by paragraph .101 of GRAP 19; and
 - (ii) the reasons why the liability cannot be measured reliably.
- (j) Additional contingent liabilities and contingent assets assumed or acquired or received in the transfer of functions.
- (k) For transactions that are recognised separately from the acquisition or receipt of assets, assumption of liabilities and the acquisition or receipt of any non-controlling interests in the transfer of functions in accordance with paragraph .99:
- (i) a description of each transaction;

- (ii) how the acquirer accounted for each transaction;
 - (iii) the amounts recognised for each transaction and the line item in the financial statements in which each amount is recognised; and
 - (iv) if the transaction is the effective settlement of a pre-existing relationship, the method used to determine the settlement amount.
- (l) The disclosure of separately recognised transactions required by (j) shall include the amount of acquisition-related costs and, separately, the amount of those costs recognised as an expense and the line item or items in the statement of financial performance in which those expenses are recognised. The amount of any issue costs not recognised as an expense and how they were recognised should also be disclosed.
- (m) For each transfer of function in which the acquirer holds less than 100 per cent of the residual interests in the acquiree at the acquisition date:
- (i) the amount of the non-controlling interest in the acquiree recognised at the acquisition date and the measurement basis for that amount; and
 - (ii) for each non-controlling interest in an acquiree measured at fair value, the valuation technique(s) and significant inputs used to measure that value.
- (n) In a transfer of functions achieved in stages:
- (i) the acquisition-date fair value of the residual interest in the acquiree held by the acquirer immediately before the acquisition date; and
 - (ii) the amount of any gain or loss recognised as a result of remeasuring to fair value the residual interest in the acquiree held by the acquirer before the transfer of functions (see paragraph .92) and the line item in the consolidated statement of financial performance in which that gain or loss is recognised.
- (o) The following information:
- (i) the amounts of revenue and expense, and the surplus or deficit of the acquiree since the acquisition date included in the consolidated statement of financial performance for the reporting period; and
 - (ii) the revenue and expense, and the surplus or deficit of the acquirer for the current reporting period as though the acquisition date for all transfer of functions that occurred during the year had been as of the beginning of the annual reporting period.

If disclosure of any of the information required by this subparagraph is impracticable, the acquirer should disclose that fact and explain why the disclosure is impracticable. This Standard uses the term “impracticable” with the same

meaning as in GRAP 3.

- .119 The acquirer shall disclose the difference between the assets acquired or received, liabilities assumed, any non-controlling interests and the consideration transferred (if any), as a separate line item in the statement of financial performance.**
- .120 For individually immaterial transfer of functions occurring during the reporting period that are material collectively, the acquirer shall disclose in aggregate the information required by paragraphs .118(e) to (o).**
- .121 If the acquisition date of a transfer of functions is after the end of the reporting period but before the financial statements are authorised for issue, the acquirer should disclose the information required by paragraph .118 unless the initial accounting for the transfer of functions is incomplete at the time the financial statements are authorised for issue. In that situation, the acquirer should describe which disclosures could not be made and the reasons why they cannot be made.
- .122 The acquirer meets the needs of the users of its financial statements for information about the acquiree prior to the transfer of functions by making the disclosures in paragraph .118(o) .
- .123 The acquirer shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to transfer of functions that occurred in the period or previous reporting periods.**
- .124 To meet the objective in paragraph .123, the acquirer shall disclose the following information for each material transfer of functions or in the aggregate for individually immaterial transfer of functions that are material collectively:**
- (a) **If the initial accounting for a transfer of functions is incomplete (see paragraph .93) for particular assets, liabilities, non-controlling interests or items of consideration and the amounts recognised in the financial statements for the transfer of functions thus have been determined only provisionally:**
- (i) **the reasons why the initial accounting for the transfer of functions is incomplete;**
- (ii) **the assets, liabilities, residual interest or items of any consideration for which the initial accounting is incomplete; and**
- (iii) **the nature and the amount of any measurement period adjustments recognised during the reporting period in accordance with paragraph .97.**
- (b) **For each reporting period after the acquisition date until the entity collects, sells or otherwise loses the right to a contingent consideration**

asset, or until the entity settles a contingent consideration liability or the liability is cancelled or expires:

- (i) any changes in the recognised amounts, including any differences arising upon settlement;**
 - (ii) any changes in the range of outcomes (undiscounted) and the reasons for those changes; and**
 - (iii) the valuation techniques and key model inputs used to measure contingent consideration.**
- (c) For contingent liabilities recognised in a transfer of functions, the acquirer shall disclose the information required by paragraphs .107 and .108 of GRAP 19 for each class of provision.**
- (d) The amount and an explanation of any gain or loss recognised in the current reporting period that both:**
- (i) relates to the identifiable assets acquired or received, or liabilities assumed and any non-controlling interests in a transfer of functions that was effected in the current or previous reporting period; and**
 - (ii) is of such a size, nature or incidence that disclosure is relevant to understanding the acquirer's financial statements.**
- (e) If amounts of tax due are forgiven as a result of the terms of the transfer of functions (see paragraphs .67 and .68).**

.125 If the specific disclosures required by this and other Standards of GRAP do not meet the objectives set out in paragraphs .118 and .124, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

Transitional provisions

Initial adoption of the Standards of GRAP

.126 The transitional provisions to be applied by entities on the initial adoption of this Standard are prescribed in a directive(s). The provisions of this Standard shall be read in conjunction with each applicable directive.

Effective date

Initial adoption of the Standards of GRAP

.127 An entity shall apply this Standard for annual financial statements covering periods beginning on or after a date to be determined by the Minister of Finance in a regulation to be published in accordance with section 91(1)(b) of the Public Finance Management Act, Act No. 1 of 1999 (PFMA), as amended.



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Withdrawal of the Standard of GRAP on *Transfer of Functions Between Entities Not Under Common Control* (2010)

.128 This Standard supersedes the Standard of GRAP on *Transfer of Functions Between Entities Not Under Common Control* issued in 2010.

Appendix A – Application guidance

This appendix is an integral part of this Standard.

Optional test to identify concentration of fair value (see paragraph .15)

- AG1. Paragraph .15 of this Standard allows an entity to apply, or not apply an optional test (the concentration test). The concentration test is a simplified assessment to decide if an acquired or received set of activities and assets and/or liabilities is not a function. An entity may make such an election separately for each transaction or other event
- AG2. The concentration test is met, i.e the activities, assets and/or liabilities is not a function, if substantially all of the fair value of the gross assets acquired or received is concentrated in a single identifiable asset or group of similar identifiable assets. For the concentration test:
- (a) the fair value of the gross assets acquired or received should exclude cash and cash equivalents;
 - (b) the fair value of the gross assets acquired or received should include any consideration transferred (plus the fair value of any non-controlling interest and the fair value of any previously held interest) in excess of the fair value of net assets acquired or received. The fair value of the gross assets acquired or received may normally be determined as the total obtained by adding the fair value of the consideration transferred (plus the fair value of any non-controlling interest and the fair value of any previously held interest) to the fair value of the liabilities assumed, and then excluding the items identified in subparagraph (a). However, if the fair value of the gross assets acquired or received is more than that total, a more precise calculation may sometimes be needed;
 - (c) a single identifiable asset should include any asset or group of assets that would be recognised and measured as a single identifiable asset in a transfer of functions;
 - (d) if a tangible asset is attached to, and cannot be physically removed and used separately from, another tangible asset (or from an underlying asset subject to a lease, as defined in the Standard of GRAP on *Leases*, without incurring significant cost, or significant diminution in utility or fair value to either asset (for example, land and buildings), those assets should be considered a single identifiable asset;
 - (e) when assessing whether assets are similar, an entity should consider the nature of each identifiable single asset and the risks associated with managing and creating outputs from the assets (that is, the risk characteristics); and
 - (f) the following should not be considered similar assets:
 - (i) a tangible asset and an intangible asset;

- (ii) tangible assets in different classes (for example, inventory, infrastructure and vehicles) unless they are considered a single identifiable asset in accordance with the criterion in subparagraph (d);
- (iii) intangible assets in different classes (for example, brand names, licences and intangible assets under development);
- (iv) a financial asset and a non-financial asset;
- (v) financial assets in different classes (for example, accounts receivable and investments in residual interests); and
- (vi) assets that are within the same class of asset but have significantly different risk characteristics.

AG3. The requirements in paragraph AG2 do not modify the guidance on similar assets in GRAP 31, nor do they modify the meaning of the term “class” in the Standard of GRAP on *Property, Plant and Equipment*, GRAP 31 and the Standard of GRAP on *Financial Instruments*.

AG4. Applying the concentration test has the following consequences:

- (a) if the concentration test is met, the set of activities and assets and/or liabilities is not a function and no further assessment is needed; or
- (b) if the concentration test is not met, or if the entity elects not to apply the test, the entity should assess if a particular set of activities and assets and/or liabilities meets the definition of a function (see paragraph .16 of this Standard.)

AG5. For the definition of a function to be met, paragraph .17 of this Standard explains that, to be considered a function, an acquired or received set of activities and assets and/or liabilities must include, as a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs.

Assessing if an acquired or received process is substantive (see paragraph .17)

AG6. Paragraphs AG7 to AG10 explain how to assess whether an acquired or received process is substantive if the transferred set of activities and assets and/or liabilities does not have outputs (paragraph AG8) and if it does have outputs (paragraph AG10).

AG7. An example of an acquired or received set of activities and assets and/or liabilities that does not have outputs at the acquisition date is an early-stage entity that has not started providing good and/or services. Moreover, if an acquired or received set of activities and assets and/or liabilities have future economic benefits or service potential at the acquisition date, it is considered to have outputs at that date, even if subsequently it will no longer has future economic benefits or service potential, for example because it will be integrated by the acquirer.

- AG8. If a set of activities and assets and/or liabilities does not have outputs at the acquisition date, an acquired or received process (or group of processes) should be considered substantive only if:
- (a) it is critical to the ability to develop or convert an acquired or received input or inputs into outputs;
 - (b) the inputs acquired or received include both an organised workforce that has the necessary skills, knowledge or experience to perform that process (or group of processes) and other inputs that the organised workforce could develop or convert into outputs. An organised workforce is a workforce that understands and knows how to operate the process that is acquired or received as part of the transfer, to create the outputs. The outputs could include:
 - (i) intellectual property that could be used to develop a good or service;
 - (ii) other resources that could be developed to create outputs; or
 - (iii) rights to obtain access to necessary materials or rights that enable the creation of future outputs.

Examples of the inputs mentioned in subparagraphs (b)(ii) to (iii) include technology, and in-process research and development projects.

- AG9. If a set of activities and assets and/or liabilities has outputs at the acquisition date, an acquired or received process (or group of processes) should be considered substantive if, when applied to an acquired or received input or inputs, it:
- (a) is critical to the 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 group of processes); or
 - (b) significantly contributes to the ability to continue producing outputs and;
 - (i) is considered unique or scarce; or
 - (ii) cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.

- AG10. The following additional discussion supports both paragraphs AG9 and AG10:
- (a) An acquired or received contract is an input and not a substantive process. Nevertheless, an acquired or received contract, for example a contract for outsourced asset management, may give access to an organised workforce. An entity should assess whether an organised workforce accessed through such a contract performs a substantive process that the entity controls, and thus has been acquired or received. Factors to be



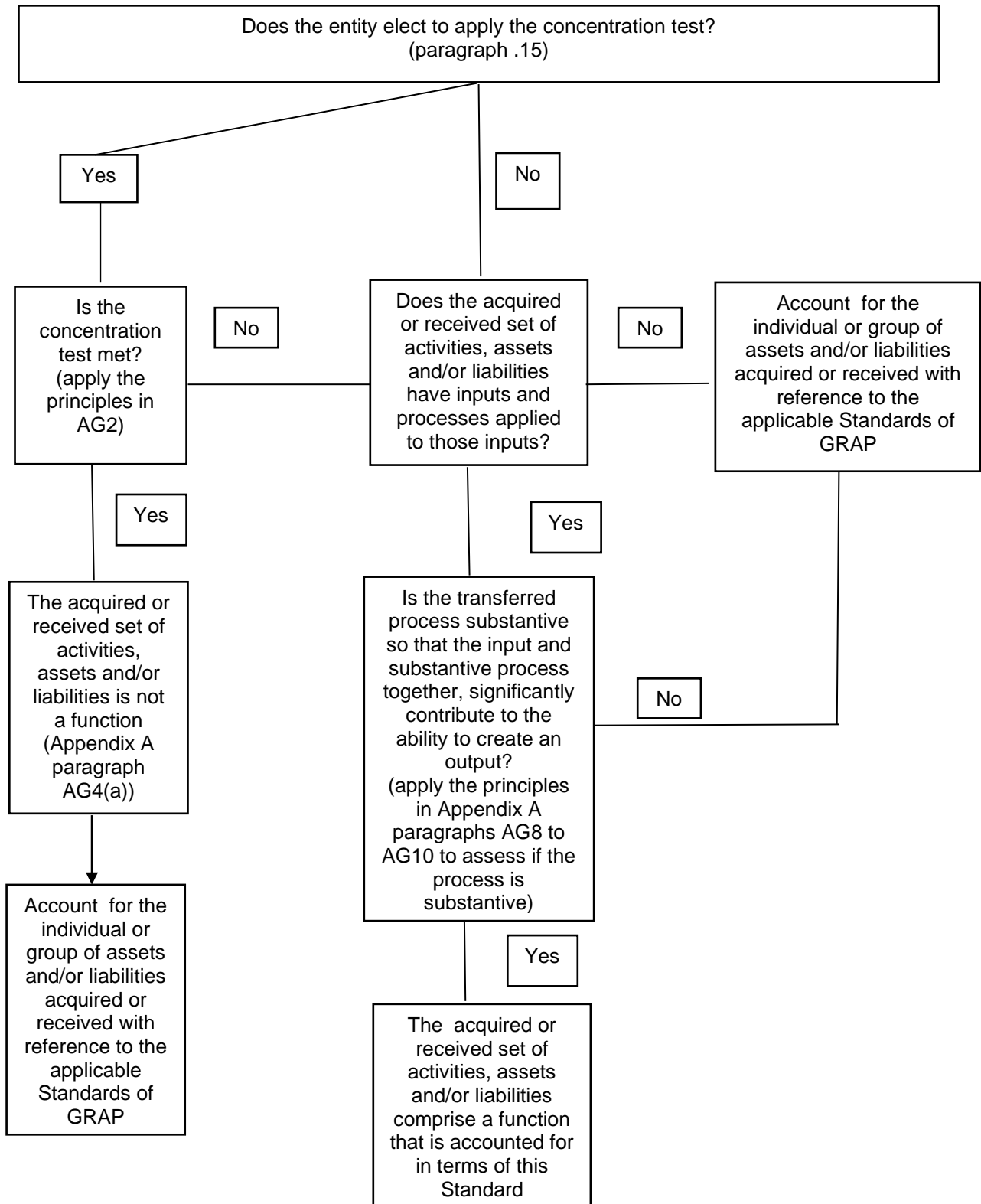
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considered in making that assessment include the duration of the contract and its renewal terms.

- (b) Difficulties in replacing an acquired or received organised workforce may indicate that the acquired or received organised workforce performs a process that is critical to the ability to create outputs.
- (c) A process (or group of processes) is not critical if, for example, it is ancillary or minor within the context of all the processes required to create outputs.

AG11. The following diagram explains the steps and related accounting to be applied to assess if an acquired or received set of activities, assets and/or liabilities where an entity elects, or not, to apply the concentration test, is a function.

Is a set of activities, assets and/or liabilities, where an entity elects, or not elect to apply the concentration test, a function?



Appendix B - Consequential amendments to Standards of GRAP

The purpose of this appendix is to identify the consequential amendments to other Standards of GRAP resulting from the issue of this Standard. Amended text is shown with new text underlined and deleted text struck through.

B1. DIRECTIVE 2 *Transitional Provisions for Public Entities, Trading Entities, Municipal Entities, Public Technical and Vocational Education and Training Colleges, and Constitutional Institutions*

Amend and delete the following paragraphs in Directive 2:

GRAP 106 *Transfer of Functions Between Entities Not Under Common Control*

Transitional provisions

- .91** *The requirements in GRAP 106 (Revised xxx) shall be applied prospectively to a transaction or event that involves a transfer of functions when the acquisition date is on or after the initial adoption of the Standard (Revised xxx). The transitional provisions should be read in conjunction with the requirements on the measurement period as included in paragraphs .70 to .76 of the Standard (Revised xxx).*
- .92** ~~[Deleted] GRAP 105 only applies to a transfer of functions that occurs after the initial adoption of the Standard. Assets acquired and liabilities assumed as a result of a transfer of functions where the acquisition date preceded the adoption of the Standard, should not be adjusted upon initial adoption of the Standard.~~
- .93** ~~[Deleted] On the initial adoption of the Standard, the opening balance of any recognised goodwill, that arose from a transfer of functions where the acquisition date preceded the adoption of GRAP 106, should be recognised against accumulated surplus or deficit for the earliest period presented.~~

B2. DIRECTIVE 3 *Transitional Provisions for High Capacity Municipalities*

Amend and delete the following paragraphs in Directive 3:

GRAP 106 *Transfer of Functions Between Entities Not Under Common Control*

Transitional provisions

- .102** *The requirements in GRAP 106 (Revised xxx) shall be applied prospectively to a transaction or event that involves a transfer of functions when the acquisition date is on or after the initial adoption of the Standard (Revised xxx). The transitional provisions should be read in conjunction with the requirements on the measurement period as included in paragraphs .70 to .76 of the Standard (Revised xxx).*
- ~~.103 [Deleted] GRAP 106 only applies to a transfer of functions that occurs after the initial adoption of the Standard. Assets acquired and liabilities assumed as a result of a transfer of functions where the acquisition date preceded the adoption of the Standard, should not be adjusted upon initial adoption of the Standard.~~
- ~~.104 [Deleted] On the initial adoption of the Standard, the opening balance of any recognised goodwill, that arose from a transfer of functions where the acquisition date preceded the adoption of GRAP 106, should be recognised against accumulated surplus or deficit for the earliest period presented.~~

B3. DIRECTIVE 4 *Transitional Provisions for Medium and Low Capacity Municipalities and Trading Entities*

Amend and delete the following paragraphs in Directive 4:

GRAP 106 *Transfer of Functions Between Entities Not Under Common Control*

Transitional provisions

- .129** *The requirements in GRAP 106 (Revised xxx) shall be applied prospectively to a transaction or event that involves a transfer of functions when the acquisition date is on or after the initial adoption of the Standard (Revised xxx). The transitional provisions should be read in conjunction with the requirements on the measurement period as included in paragraphs .70 to .76 of the Standard (Revised xxx).*
- ~~.130 [Deleted] GRAP 106 only applies to a transfer of functions that occurs after the initial adoption of the Standard. Assets acquired and liabilities assumed as a result of a transfer of functions where the acquisition date preceded the adoption of the Standard, should not be adjusted upon initial adoption of the Standard.~~
- ~~.134 [Deleted] On the initial adoption of the Standard, the opening balance of any recognised goodwill, that arose from a transfer of functions where the acquisition date preceded the adoption of GRAP 106, should be recognised against accumulated surplus or deficit for the earliest period presented.~~

B4. DIRECTIVE 8 *Transitional Provisions for Parliament and Provincial Legislatures*

Amend and delete the following paragraphs in Directive 8:

GRAP 106 *Transfer of Functions Between Entities Not Under Common Control*

Transitional provisions

- .90** *The requirements in GRAP 105 (Revised xxx) shall be applied prospectively to a transaction or event that involves a transfer of functions when the acquisition date is on or after the initial adoption of the Standard (Revised xxx). The transitional provisions should be read in conjunction with the requirements on the measurement period as included in paragraphs .70 to .76 of the Standard (Revised xxx).*
- .91** ~~[Deleted] GRAP 106 only applies to a transfer of functions that occurs after the initial adoption of the Standard. Assets acquired and liabilities assumed as a result of a transfer of functions where the acquisition date preceded the adoption of the Standard, should not be adjusted upon initial adoption of the Standard.~~
- .92** ~~Deleted] On the initial adoption of the Standard, the opening balance of any recognised goodwill, that arose from a transfer of functions where the acquisition date preceded the adoption of GRAP 106, should be recognised against accumulated surplus or deficit for the earliest period presented.~~

Illustrative Examples

These examples accompany, but are not part of, GRAP 106

Assessing if a transaction or event is a transfer of function, and if it occurs between entities not under common control

- IE1. A national public entity (Entity A) that is currently runs a nutritional programme for unemployed persons, is mandated by new legislation to transfer this programme to a provincial public entity (Entity B). As part of the transfer, the employees that are responsible for the nutritional programme, including any moveable assets (such as laptops and printers) used by them to perform the functions are also transferred to Entity B, along with any liabilities related to the programme.
- IE2. To assess if the transfer of functions needs to be accounted for using GRAP 106 the following should be assessed (see paragraph .05 in GRAP 106):
- Do the assets acquired or received and/or the liabilities assumed meet the definition of a function?: Yes – both the employees, assets used to perform the functions and any related liabilities are transferred from Entity A to Entity B. This includes the processes applied to perform the function. The transfer is an integrated set of activities that is capable of being conducted and managed for the purpose of achieving Entity A’s objectives as it will be included as a new programme, i.e. service delivery objective, of Entity A.
 - Does the transaction or event involve the formation of a joint arrangements?: No, two or more parties do not have joint control, as neither of the parties involved in the transaction or event agreed the sharing of control by way of a binding arrangement. Furthermore, the unanimous consent of the parties sharing the control is also not required in the binding arrangement. A joint arrangement is therefore not established.
 - Can an acquirer be identified: Yes, Entity B is the acquirer in the new legislation.
 - Is the transaction or event between entities under common control?: No, the transaction occurred between two entities in the different spheres of government, i.e. the national and provincial sphere.
- IE3. The transaction should therefore be accounted as a transfer of functions between entities not under common control using GRAP 106.

Definition of a function

- IE4. The examples in paragraphs IE5–IE36 illustrate application of the guidance in GRAP 106 paragraphs .14 to .20 (including the guidance in Annexure A paragraphs AG1 to AG11) on the definition of a function.

Example A—receipt of staff accommodation

Scenario 1—Background

IE5. Entity A receives a portfolio of 10 single-family homes to be used for staff accommodation that each have an in-place lease. The fair value of the consideration paid is equal to the aggregate fair value of the 10 single-family homes received. Each single-family home includes the land, building and property improvements. Each home has a different floor area and interior design. The 10 single-family homes are located in the same area and the staff that will occupy the homes are similar. No employees, other assets, processes or other activities are received.

Scenario 1—Application of requirements

IE6. Entity A elects to apply the optional concentration test set out in Annexure A paragraph AG2 and concludes that:

- (a) Each single-family home is considered a single identifiable asset in accordance with Annexure A paragraph AG2 for the following reasons:
 - (i) the building and property improvements are attached to the land and cannot be removed without incurring significant cost; and
 - (ii) the building and the in-place lease are considered a single identifiable asset, because they would be recognised and measured as a single identifiable asset in a transfer of functions.
- (b) The group of 10 single-family homes is a group of similar identifiable assets because the assets (all single-family homes) are similar in nature and the risks associated with managing and creating outputs are not significantly different. This is because the types of homes and staff that will occupy the homes are not significantly different.
- (c) Consequently, substantially all of the fair value of the gross assets received is concentrated in a group of similar identifiable assets.

IE7. Therefore, Entity A concludes that the received set of activities and assets is not a function.

Scenario 2—Background

IE8. Assume the same facts as in Scenario 1 except that Entity also receives a multi-tenant office park with six 10-storey office buildings that are fully leased. The additional set of activities and assets received includes the land, buildings, leases and contracts for outsourced cleaning, security and maintenance. No employees, other assets, other processes or other activities are received. The aggregate fair value associated with the office park is similar to the aggregate fair value associated with the 10 single-family homes. The processes performed through the contracts for outsourced cleaning and security are ancillary or minor within the context of all the processes required to create outputs.



Scenario 2—Application of requirements

- IE9. Entity A elects to apply the optional concentration test set out in Annexure A paragraph AG2 and concludes that the single-family homes and the office park are not similar identifiable assets, because the single-family homes and the office park differ significantly in the risks associated with operating the assets, obtaining tenants and managing tenants. In particular, the scale of operations and risks associated with the two classes of customers are significantly different. Consequently, the fair value of the gross assets received are not substantially all concentrated in a group of similar identifiable assets, because the fair value of the office park is similar to the aggregate fair value of the 10 single-family homes. Thus Entity A assesses whether the set meets the minimum requirements to be considered a function in accordance with paragraphs .17 to .20 and Appendix A paragraphs AG6 to AG10.
- IE10. The set of activities and assets has outputs because it generates revenue through the in-place leases. Consequently, Entity A applies the criteria in Annexure A paragraph AG9 to determine whether any processes received are substantive.
- IE11. Entity A concludes that the criterion in Annexure A paragraph AG9(a) is not met because:
- (a) the set does not include an organised workforce; and
 - (b) Entity A considers that the processes performed by the outsourced cleaning, security and maintenance personnel (the only processes received) are ancillary or minor within the context of all the processes required to create outputs (see Annexure A paragraph AG10(c)) and, therefore, are not critical to the ability to continue producing outputs.
- IE12. After considering the only processes received, those performed by the outsourced cleaning, security and maintenance personnel, Entity A also concludes that the criteria in Annexure A paragraph AG9(b) are not met. Either of the following reasons justifies that conclusion:
- (a) the processes do not significantly contribute to the ability to continue producing outputs; and
 - (b) the processes are readily accessible in the marketplace. Thus, they are not unique or scarce. In addition, they could be replaced without significant cost, effort, or delay in the ability to continue producing outputs.
- IE13. Because none of the criteria in Annexure A paragraph AG9 is met, Entity A concludes that the received set of activities and assets is not a function.

Scenario 3—Background

- IE14. Assume the same facts as in Scenario 2, except that the received set of activities and assets also includes the employees responsible for leasing, tenant management, and managing and supervising all operational processes.

Scenario 3—Application of requirements

- IE15. Entity A elects not to apply the optional concentration test set out in Annexure A paragraph AG2 and therefore assesses whether the set meets the minimum requirements to be considered a function in accordance with Annexure A paragraphs AG6 to AG10.
- IE16. The received set of activities and assets has outputs because it generates revenue through the in-place leases. Consequently, Entity A applies the criteria in Annexure A paragraph AG9.
- IE17. Entity A concludes that the criterion in Annexure A paragraph AG9(a) is met because the set includes an organised workforce with the necessary skills, knowledge or experience to perform processes (i.e. leasing, tenant management, and managing and supervising the operational processes) that are substantive because they are critical to the ability to continue producing outputs when applied to the received inputs (i.e. the land, buildings and in-place leases). Furthermore, Entity A concludes that the criterion in paragraph .18 is met because those substantive processes and inputs together significantly contribute to the ability to create output. Consequently, Entity A concludes that the received set of activities and assets is a function.

Example B—acquisition of a drug candidate

Scenario 1—Background

- IE18. Entity A purchases a legal entity that contains:
- (a) the rights to an in-process research and development project that is developing a compound to treat diabetes and is in its final testing phase (Project 1). Project 1 includes the historical know-how, formula protocols, designs and procedures expected to be needed to complete the final testing phase; and
 - (b) a contract that provides outsourced clinical trials. The contract is priced at current market rates and a number of vendors in the marketplace could provide the same services. Therefore, the fair value associated with this contract is nil. Entity A has no option to renew the contract.

No employees, other assets, other processes or other activities are acquired.

Scenario 1—Application of requirements

- IE19. Entity A elects to apply the optional concentration test set out in Annexure A paragraph AG2 and concludes that:
- (a) project 1 is a single identifiable asset because it would be recognised and measured as a single identifiable intangible asset in a transfer of functions; and
 - (b) because the acquired contract has a fair value of nil, substantially all of the fair value of the gross assets acquired is concentrated in Project 1.



IE20. Consequently, Entity A concludes that the acquired set of activities and assets is not a function.

Scenario 2—Background

IE21. Assume the same facts as in Scenario 1 except that the acquired set of activities and assets also includes another in-process research and development project that is developing a compound to treat Alzheimer's disease and is in its final testing phase (Project 2). Project 2 includes the historical know-how, formula protocols, designs, and procedures expected to be needed to complete the final phase of testing. The fair value associated with Project 2 is similar to the fair value associated with Project 1. No employees, other assets, processes or other activities are acquired.

Scenario 2—Application of requirements

IE22. Entity A elects to apply the optional concentration test set out in Annexure A paragraph AG2 and concludes that:

- (a) Project 1 and Project 2 are identifiable intangible assets that would each be recognised and measured as a separate identifiable asset in a transfer of functions;
- (b) Project 1 and Project 2 are not similar identifiable assets because significantly different risks are associated with managing and creating outputs from each asset. Each project has significantly different risks associated with developing, completing and marketing the compound to customers. The compounds are intended to treat significantly different medical conditions, and each project has a significantly different potential customer base; and
- (c) consequently, the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets. Therefore, Entity A assesses whether the set meets the minimum requirements to be considered a function in accordance with paragraphs .17 to .20 and Annexure A paragraphs AG6 and AG7.

IE23. The acquired set of activities and assets does not have outputs because it has not started generating revenue. Thus, Entity A applies the criteria in Annexure A paragraph AG8. Entity A concludes that those criteria are not met for the following reasons:

- (a) the set does not include an organised workforce; and
- (b) although the contract that provides outsourced clinical trials might give access to an organised workforce that has the necessary skills, knowledge or experience to perform processes needed to carry out the clinical trials, that organised workforce cannot develop or convert the inputs acquired by Entity A into outputs.



Successful clinical trials are a pre-condition for producing output, but carrying out those trials will not develop or convert the acquired inputs into outputs.

- IE24. Consequently, Entity A concludes that the acquired set of activities and assets is not a function.

Example C—acquisition of a biotech entity

Background

- IE25. Entity A purchases a legal entity (Entity B). Entity B's operations include research and development activities on several drug compounds that it is developing (in-process research and development projects); senior management and scientists who have the necessary skills, knowledge, or experience to perform research and development activities; and tangible assets (including the headquarters, a research lab, and lab equipment). Entity B does not yet have a marketable product and has not yet generated revenue. Each of the assets acquired has a similar fair value.

Application of requirements

- IE26. It is evident that the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets. Thus, the optional concentration test set out in Annexure A paragraph AG2 would not be met. Consequently, Entity A assesses whether the set meets the minimum requirements to be considered a function in accordance with paragraphs .17 to .20 and Annexure A paragraphs AG1 to AG11.
- IE27. Entity A first assesses whether it has acquired any processes. No process is documented. Nevertheless, the acquired organised workforce has proprietary knowledge of Entity B's ongoing projects and experience with them. Applying paragraph .14(b), Entity A concludes that the intellectual capacity of the acquired organised workforce having the necessary skills and experience following rules and conventions provides the necessary processes that are capable of being applied to inputs to create outputs.
- IE28. Entity A next assesses whether the acquired processes are substantive. The set of activities and assets does not have outputs. Thus, Entity A applies the criteria in Annexure A paragraph AG8. Entity A concludes that those criteria are met because:
- (a) the acquired processes are critical to the ability to develop or convert the acquired inputs into outputs; and
 - (b) the inputs acquired include both:
 - (i) an organised workforce that has the necessary skills, knowledge, or experience to perform the acquired processes; and
 - (ii) other inputs that the organised workforce could develop or convert into outputs. Those inputs include the in-process research and development projects.



IE29. Finally, applying the criteria in paragraph .14, Entity A concludes that the acquired substantive processes and the acquired inputs together significantly contribute to the ability to create output. Consequently, Entity A concludes that the acquired set of activities and assets is a function.

Example D—acquired of a television station

Background

IE30. Entity B purchases broadcasting assets to Entity A. The acquired set of activities and assets includes only the communications licence, the broadcasting equipment and an office building. Each of the assets acquired has a similar fair value. Entity A does not acquire the processes needed to broadcast programmes and it does not acquire any employees, other assets, other processes or other activities. Before the acquisition date, Entity B stopped broadcasting using the set of activities and assets acquired by Entity A.

Application of requirements

IE31. Entity A elects to apply the optional concentration test set out in Annexure A paragraph AG2 and concludes that:

- (a) the broadcasting equipment and building are not a single identifiable asset because the equipment is not attached to the building and can be removed without significant cost or diminution in utility or fair value of either asset;
- (b) the licence is an intangible asset, whereas the broadcasting equipment and building are tangible assets in different classes. Consequently, in accordance with Annexure A paragraph AG2(f), the assets are not considered similar to each other; and
- (c) each of the single identifiable assets has similar fair value. Thus, the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets.

IE32. As the concentration test is not met, Entity A assesses whether the set of activities and assets meets the minimum requirements to be considered a function in accordance with paragraph .17 to .20 and Annexure A paragraphs AG6 to AG10.

IE33. The set of activities and assets does not have outputs, because Entity B has stopped broadcasting. Thus, Entity A applies the criteria in Annexure A paragraph AG9. The set does not include an organised workforce, so it does not meet those criteria. Consequently, Entity A concludes that the acquired set of activities and assets is not a function.

Example E—acquisition of a closed manufacturing facility

Background

IE34. Entity A purchases a closed manufacturing facility—the land and the building—as well as the related equipment. The fair value of the equipment and the fair value of



the facility are similar. To comply with local laws, Entity A must take over the employees who worked in the facility. No other assets, processes or other activities are acquired. The acquired set of activities and assets stopped producing outputs before the acquisition date.

Application of requirements

- IE35. Entity A elects to apply the optional concentration test set out in Annexure A paragraph AG2 and concludes that:
- (a) the equipment and the facility are not a single identifiable asset because the equipment could be removed from the facility without significant cost or diminution in utility or fair value of either the equipment or the facility—the equipment is not attached to the facility and can be used in many other types of manufacturing facilities;
 - (b) the equipment and facility are not similar identifiable assets because they are in different classes of tangible assets; and
 - (c) the fair values of the equipment and the facility are similar. Therefore, the fair value of the gross assets acquired is not substantially all concentrated in a single identifiable asset or group of similar identifiable assets.
- IE36. As the concentration test is not met, Entity A assesses whether the set of activities and assets meets the minimum requirements to be considered a function in accordance with paragraphs .14 to .20 and Annexure AG6 to AG10.
- IE37. The acquired set of activities and assets does not have outputs at the acquisition date because it stopped producing outputs before then. Consequently, Entity A applies the criteria in Annexure A paragraph AG8. The set includes an organised workforce that has the necessary skills, knowledge or experience to use the equipment, but it does not include another acquired input (such as intellectual property or inventories) that the organised workforce could develop or convert into outputs. The facility and the equipment cannot be developed or converted into outputs. Consequently, Entity A concludes that the acquired set of activities and assets is not a function.

Example F—determining the fair value of the gross assets acquired

Background

- IE38. Entity A holds a 20% interest in another entity (Entity B). At a subsequent date (the acquisition date), Entity A acquires a further 50% interest in Entity B and obtains control of it. Entity B's assets and liabilities on the acquisition date are the following:
- (a) a building with a fair value of R500;
 - (b) an identifiable intangible asset with a fair value of R400;
 - (c) cash and cash equivalents with a fair value of R100; and

(d) financial liabilities with a fair value of R700.

- IE39. Entity A pays R200 for the additional 50% interest in Entity B. Entity A determines that at the acquisition date the fair value of Entity B is R400, that the fair value of the non-controlling interest in Entity B is R120 (30% x R400) and that the fair value of the previously held interest is R80 (20% x R400).

Application of requirements

- IE40. To perform the optional concentration test set out in Annexure A paragraph AG2, Entity A needs to determine the fair value of the gross assets acquired. Applying Annexure A paragraph AG2, Entity A determines that the fair value of the gross assets acquired is R1,000, calculated as follows:

- (a) the fair value of the building (R500); plus
- (b) the fair value of the identifiable intangible asset (R400); plus
- (c) the excess (R100) of:
 - (i) the sum (R400) of the consideration transferred (R200), plus the fair value of the non-controlling interest (R120), plus the fair value of the previously held interest (R80); over
 - (ii) the fair value of the net identifiable assets acquired (R300 = R500 + R400 + R100 – R700).

- IE41. The excess referred to in paragraph IE40(c) is determined in a manner similar to the initial measurement the excess of the purchase consideration paid by the acquirer in accordance with paragraph .82 of this Standard. Including this amount in determining the fair value of the gross assets acquired or received means that the concentration test is based on an amount that is affected by the value of any substantive processes acquired or received.

- IE42. The fair value of gross assets acquired or received is determined after making the following exclusions specified in Appendix A paragraph AG2(a) for items that are independent of whether any substantive process was acquired or received, the fair value of the gross assets acquired or received does not include the fair value of the cash and cash equivalents acquired (R100).

- IE43. The fair value of the gross assets acquired or received or received (R1,000) may also be determined as follows:
- (a) the total (R1,100) obtained by adding:
 - (i) the amount paid (R200) (plus the fair value of the non-controlling interest (R120) plus the fair value of the previously held interest (R80)); to
 - (ii) the fair value of the liabilities assumed (R700); less
 - (b) the cash and cash equivalents acquired (R100).

Measurement period in a transfer of functions

Illustrating the consequences of applying paragraphs .93 to .98 of GRAP 106.

- IE44. Suppose that Entity TE acquires or receives some of its functions to Entity AE on 30 September 20X7. Entity AE seeks an independent valuation for an item of property, plant and equipment acquired or received in the transfer of functions, and the valuation was not complete by the time Entity AE authorised for issue its financial statements for the year ended 31 December 20X7. In its 20X7 annual financial statements, Entity AE recognised a provisional fair value for the asset of R30 000. At the acquisition date, the item of property, plant and equipment had a remaining useful life of five years. Five months after the acquisition date, Entity AE received the independent valuation, which estimated the asset's acquisition-date fair value as R40 000.
- IE45. In its financial statements for the year ended 31 December 20X8, Entity AE retrospectively adjusts the 20X7 prior year information as follows:
- (a) The fair value of property, plant and equipment as of 31 December 20X7 is increased by R9 500. That adjustment is measured as the fair value adjustment at the acquisition date of R10 000 less the additional depreciation that would have been recognised if the asset's fair value at the acquisition date had been recognised from that date (R500 for three months' depreciation).
 - (b) The fair value amount of difference between the assets acquired or received, the liabilities assumed and the consideration transferred as of 31 December 20X7 is decreased by R10 000.
 - (c) Depreciation expense for 20X7 is increased by R500.
- IE46. In accordance with GRAP 106.91, Entity AE discloses:
- (a) In its 20X7 financial statements, that the initial accounting for the transfer of functions has not been completed because the valuation of property, plant and equipment has not yet been received.
 - (b) In its 20X8 financial statements, the amounts and explanations of the adjustments to the provisional values recognised during the current reporting period. Therefore, Entity AE discloses that the 20X7 comparative information is adjusted retrospectively to increase the fair value of the item of property, plant and equipment at the acquisition date by R9 500, offset by a decrease in accumulated surplus or deficit for the difference between the assets acquired or received, the liabilities assumed and the consideration transferred of R10 000 and an increase in depreciation expense of R500.

Determining what is part of the transfer of functions transaction

Settlement of a pre-existing relationship – loan

Illustrating the consequences of applying paragraphs .99 to .103 of GRAP 106.

- IE47. Entity AE provides Entity TE with a five year, fixed rate loan of R100. Interest is payable quarterly, with the principal repaid on maturity. With two years remaining under the loan agreement, Entity TE acquires Entity.
- IE48. Included in the total fair value of Entity TE is a R90 financial liability for the fair value of the loan arrangement with Entity AE. At the acquisition date, the fair value of the corresponding financial asset in Entity AE's financial statements (the amortised cost of the loan) is R100.
- IE49. In this example, Entity AE calculates a loss of R10. The loss is calculated as the difference between the fair value of the financial liability assumed and fair value of the corresponding financial asset previously recognised by Entity AE. In its consolidated financial statements, Entity AE will eliminate its financial asset (R100) against the fair value of Entity TE's financial liability (R90), the difference representing the loss to Entity AE.

Settlement of a pre-existing relationship – transfer of functions

Illustrating the consequences of applying paragraphs .99 to .103 of GRAP 106.

- IE50. On 1 January 20X7, Entity TE is acquired by Entity AE. Previously, on 1 October 20X6, Entity AE provided Entity TE with a grant of R800 to be used in the provision of an agreed number of training courses.
- IE51. The grant was subject to a condition that the grant would be returned proportionately to the number of training courses not delivered. At the acquisition date, Entity TE had delivered a quarter of the agreed number of courses, and recognised a liability of R600 in respect of its performance obligation, in accordance with GRAP 23. Based on past experience, Entity AE considered that Entity TE was more likely than not to deliver the training courses. It was therefore not probable that there would be a flow of resources to Entity AE, and Entity AE did not recognise an asset in respect of the grant, but accounted for the full R800 as an expense.
- IE52. In this example, Entity AE calculates a gain of R600. The gain is calculated as the liability assumed that is derecognised because, as a result of the transfer of functions, there is no longer an obligation owed to a third party.
- IE53. In this example, no corresponding asset had been recognised by Entity AE; if Entity AE had previously recognised a corresponding asset, this would be derecognised at the acquisition date, and the derecognised amount would be included in the calculation of the profit or loss.

Settlement of a pre-existing relationship – supply contract

Illustrating the consequences of applying paragraphs .99 to .103 of GRAP 106.

- IE54. Entity AE purchases electronic components from Entity TE under a five-year supply contract at fixed rates. Currently, the fixed rates are higher than the rates at which Entity AE could purchase similar electronic components from another supplier. The

supply contract allows Entity AE to terminate the contract before the end of the initial five-year term but only by paying a R6 million penalty. With three years remaining under the supply contract, Entity AE pays R50 million for Entity TE, which is the fair value of Entity TE based on what other market participants would be willing to pay.

- IE55. Included in the total fair value of Entity TE is R8 million related to the fair value of the supply contract with Entity AE. The R8 million represents a R3 million component that is 'at market' because the pricing is comparable to pricing for current market transactions for the same or similar items (selling effort, customer relationships and so on) and a R5 million component for pricing that is unfavourable to Entity AE because it exceeds the price of current market transactions for similar items. Entity TE has no other identifiable assets or liabilities related to the supply contract, and Entity AE has not recognised any assets or liabilities related to the supply contract before the transfer of functions.
- IE56. In this example, Entity AE calculates a loss of R5 million (the lesser of the R6 million stated settlement amount and the amount by which the contract is unfavourable to the acquirer) separately from the transfer of functions. The R3 million 'at-market' component of the contract is part of the difference between the assets acquired or received, liabilities assumed and the consideration transferred.
- IE57. Whether Entity AE had recognised previously an amount in its financial statements related to a pre-existing relationship will affect the amount recognised as a gain or loss for the effective settlement of the relationship. Suppose that the Standards of GRAP had required Entity AE to recognise a R6 million liability for the supply contract before the transfer of functions. In that situation, Entity AE recognises a R1 million settlement gain on the contract in surplus or deficit at the acquisition date (the R5 million measured loss on the contract less the R6 million loss previously recognised). In other words, Entity AE has in effect settled a recognised liability of R6 million for R5 million, resulting in a gain of R1 million.

Subsequent measurement of transfers, concessionary loans and similar benefits received by an acquirer or an acquired or transferred function on the basis of criteria that may change as a result of a transfer of functions

Illustrating the consequences of applying paragraphs .110 to .112 of GRAP 106.

- IE58. The following example illustrates the subsequent accounting for a transfer acquired or received by an acquirer on the basis of criteria that may change as a result of a transfer of functions.
- IE59. On 1 January 20X6, a national government provides an annual grant to those municipalities where their revenue per head of population is below a threshold. On 1 June 20X3 Entity AE, Entity TE, a shopping complex that will generate revenue for Entity AE, is acquired or received by a municipality. Entity AE had previously received a grant of R500, based on its revenue per head of population.

- IE60. As a result of the acquisition or receipt of Entity TE on 1 June 20X3, the revenue per head of population of Entity AE increases above the threshold that the government had set when allocating grants.
- IE61. On 1 July 20X3, the national government requires Entity AE to repay a portion (R100) of the grant previously received by Entity AE. Entity AE recognises a liability and an expense of R100 on 1 July 20X3.

Disclosure requirements relating to transfer of functions

Illustrating the consequences of applying the disclosure requirements in paragraphs .117 to .125 of GRAP 106.

- IE62. The following example illustrates some of the disclosure requirements relating to transfer of functions; it is not based on an actual transaction. The example assumes that Entity AE is responsible for healthcare in its region. The illustration presents the disclosures in a tabular format that refers to the specific disclosure requirements illustrated.

Paragraph reference

- .118(a)–(d) On 30 June 20X2 Entity AE acquired 75 percent of the ordinary shares of Entity TE and obtained control of Entity TE. This is a transfer of functions between entities not under common control. Entity TE is a provider of medical supplies. As a result of the transfer of functions, Entity AE is expected to deliver improved healthcare to its residents. It also expects to reduce costs through economies of scale.

At 30 June 20X2

Paragraph reference		R'000
	Consideration	
.118(e)(i)	Cash	11 000
.118(e)(ii)	Contingent consideration arrangement	1 000
.118(f)(i)		
.118(g)	Total consideration transferred	12 000
.118(l)	Acquisition related costs	1 250
.118(h)	Recognised amounts of identifiable assets acquired or received and liabilities assumed	
	Financial assets	3 500

	Inventory	1 000
	Property, plant and equipment	10 000
	Identifiable intangible assets	3 300
	Financial assets	(4 400)
	Contingent liability	(1 000)
	Total identifiable net assets	12 800
.118(j)	Non-controlling interests in Entity TE	(3 300)
		9 500

.118(e)(iii) .118(f) .124(b)	<p>The contingent consideration arrangement requires Entity AE to pay the former owners of Entity TE 5 percent of the revenues of Entity XE, an unconsolidated equity investment owned by Entity TE, in excess of R7,500 for 20X3, up to a maximum amount of R2,500 (undiscounted).</p> <p>The potential undiscounted amount of all future payments that Entity AE could be required to make under the contingent consideration arrangement is between R0 and R2,500.</p> <p>The fair value of the contingent consideration arrangement is R1,000. Key assumptions include a discount rate range of 20–25 percent and assumed probability-adjusted revenues in Entity XE of R10,000–20,000.</p> <p>As of 31 December 20X2, neither the amount recognised for the contingent consideration arrangement, nor the range of outcomes or the assumptions used to develop the estimates had changed.</p>
.118(g)	The fair value of the financial assets acquired or received includes receivables with a fair value of R2,375. The gross amount due under the contracts is R3,100, of which R450 is expected to be uncollectible.
.124(a)	The fair value of the acquired or received identifiable intangible assets of R3,300 is provisional pending receipt of the final valuations for those assets.
.118(i) .124(c) GRAP	A contingent liability of R1,000 has been recognised for expected warranty claims on products sold by Entity TE during the last three years. We expect that the majority of this expenditure will be incurred in 20X3 and that all will be incurred

19.107 and .108	by the end of 20X4. The potential undiscounted amount of all future payments that Entity AE could be required to make under the warranty arrangements is estimated to be between R500 and R1,500. As of 31 December 20X2, there has been no change since 30 June 20X2 in the amount recognised for the liability or any change in the range of outcomes or assumptions used to develop the estimates.
.118(m)	The fair value of the non-controlling interest in Entity TE, a listed entity, was measured using the closing market price of Entity TE's ordinary shares on the acquisition date.
.118(m)(i)	The revenue since 30 June 20X2 contributed by Entity TE was R4,090. Entity TE also contributed profit of R1,710 over the same period.
.118(m)(ii)	Had TE been consolidated from 1 January 20X2, revenue of R27,670 and a profit of R12,870 would have been reflected.

In considering the disclosures related to the transfer of functions, an entity may find it helpful to refer to the Guideline on *The Application of Materiality to Financial Statements*.

Basis for conclusions

This basis for conclusions gives the Accounting Standards Board's (the Board's) reasons for accepting or rejecting certain proposals related to the accounting for transfer of functions between entities not under common control. This basis for conclusions accompanies, but is not part of, this Standard.

Initial development of this Standard

- BC1. This basis for conclusions summarises the Board's considerations in developing the proposed GRAP 106. In forming its views, the Board considered the views expressed and the comment received from stakeholders that responded to the Invitation to Comment (ITC) of a Discussion Paper on *Transfer of Functions* (Discussion Paper 4) issued in November 2007.
- BC2. A project on the accounting for entity combinations arising from exchange transactions is included on the International Public Sector Accounting Standards Board's (IPSASB) work programme. The Board will continue to monitor this project and, at an appropriate time, consider the implications of the IPSASB project on this Standard. The Board further considered the responses to an ITC on an Exposure Draft of this Standard (issued July 2010).

Background

- BC3. In Discussion Paper 4, the Board proposed that a Standard of GRAP equivalent of the International Financial Reporting Standard on *Business Combinations* (IFRS[®] 3) (2008) issued by the International Accounting Standards Board[®] dealing with entity combinations should be issued and that entity combinations arising from exchange transactions undertaken between entities not under common control also be included in the scope of the project. It was also proposed that a Standard of GRAP should be developed to deal with transfer of functions undertaken between entities that are:
- under common control, whether by way of an exchange and a non-exchange transaction; and
 - not under common control by way of a non-exchange transaction.
- BC4. Following proposals from respondents to Discussion Paper 4 to include a transaction or event undertaken between entities not under common control by way of a non-exchange transaction in the scope of the IFRS 3 equivalent Standard of GRAP, the Board agreed to the development of the following Standards:
- This Standard to include in its scope a transaction or event undertaken between entities not under common control by way of an exchange and non-exchange transaction; and

- GRAP 105 to include in its scope a transaction or event undertaken between entities under common control.

BC5. Some respondents to the Exposure Draft also requested that the same approach should be applied in accounting for all transactions or events that involve a transfer of functions within government. However, the Board concluded that in a transfer of functions undertaken between entities under common control there will be no effect on the consolidated financial statements, whereas a transfer of functions undertaken between entities not under common will have an effect on the consolidated financial statements. The Board reconfirmed its view that two separate Standards should be develop for transactions or events undertaken between entities under common control, and those undertaken between entities not under common control.

BC6. Discussion Paper 4 also proposed accounting principles for a transaction or event where an acquirer cannot be identified, and as a result, one entity is not deemed to gain control over another entity. Respondents therefore supported the development of a separate Standard of GRAP on mergers.

Common control

BC7. The government of the Republic of South Africa is divided into three different spheres, i.e. national, provincial and local, each given independence from the decision-making of another sphere. Control for accounting purposes is defined in the Standard of GRAP on *Consolidated and Separate Financial Statements* as: “The power to govern the financing and operating policies of an entity so as to obtain benefit from its activities”. The key consideration in determining whether or not control exists for accounting purposes is that an entity must be able to demonstrate both that it has certain decision-making capabilities over another, and that it benefits from the activities of that entity.

BC8. The national government is responsible for setting the overall policies and objectives for all three spheres of government in line with the prescripts of the Constitution of the Republic of South Africa, 1996. Each sphere of government is in turn responsible for executing its assigned functions in line with the overall policies and objectives set by national government. In effect, national government benefits from the activities undertaken by the various spheres of government, as these contribute to it achieving its overall policies and objectives.

BC9. However, each sphere is autonomous from national government in executing those policies and objectives, i.e. each sphere of government can decide how it will achieve those objectives both operationally and financially. The fact that national government provides funding for these operations and may regulate the operating environment does not necessarily imply control for financial reporting purposes. Entities within one sphere of government are thus independent from entities in another sphere.

- BC10. In South Africa, this is further applied through the requirement in sections 8 and 19 of the PFMA that requires the preparation of consolidated financial statements on a national and provincial level. The entities included in such consolidations may, from an accounting perspective, not necessarily be required to prepare such consolidated financial statements. Similarly, section 122 of the Municipal Finance Management Act, Act No. 56 of 2003, requires the preparation of consolidated financial statements from a municipal perspective.
- BC11. In rare circumstances, for example, through national legislation, an entity in one sphere of government may intervene in the administration of an entity in another sphere of government, if that other entity cannot and does not fulfil its executive obligation. For example, an entity in the national sphere of government may intervene in the administration of a municipality if that municipality is unable to fulfil its constitutional or legislative mandate. These interventions mean that executive decisions are taken on behalf of the other entity until it is able to fulfil its legislative obligations. Such interventions are usually only temporary in nature. However, during this period, circumstances must be evaluated to establish whether or not the intervention meets the definition of control.

Scope

Transfer of individual assets or groups of assets and/or liabilities (paragraphs .02(a) and .06)

- BC12. Arrangements that require one entity to take over an asset or a group of assets, or a liability or a group of liabilities of another entity are outside the scope of this Standard, as these arrangements are merely the acquisition of an asset or a group of assets, or the assumption of a liability or a group of liabilities.

Mergers (paragraphs .02(c) and .07)

- BC13. A merger involves the creation of a new combined entity in which none of the former entities obtains control over any other and no acquirer can be identified. Determining whether an acquirer can be identified includes a consideration of, amongst other things, which of the combining entities initiated the transaction or event, the relative size of the combining entities, as well as whether the assets or revenue of one of the entities involved in the transaction or event significantly exceed those of the other entities. The combining entities rather came together for the mutual sharing of risks and benefits of the combined entity. Discussion Paper 4 considered various alternatives to account for a transaction or event that meets the definition of merger. In considering IFRS 3, the Board agreed that the acquisition method will not be appropriate to account for a transaction or event that meets the definition of merger. The acquisition method requires the identification of an acquirer that obtains control of an acquiree in a transaction or event that meets the definition of a business combination, as defined in IFRS 3. In a merger an acquirer is not identified. A merger involves the establishment of a new reporting entity, formed from combining entities that come together for the mutual sharing of risks and benefits. A merger does thus not result in one entity obtaining control over

another. While entities in a transfer of functions obtain control over another entity, mergers do not involve control. GRAP 107 should be applied in accounting for a merger.

A transaction or event undertaken between entities not under common control (paragraphs .02 and .08)

BC14. A transaction or event in which an acquirer can be identified and that results in a transfer of functions between entities in different spheres of government, and/or between entities that are not part of the same economic entity, falls within the scope of this Standard as the transaction or event is undertaken between entities not under common control. The entities involved in the transfer of functions are not ultimately controlled by the same entity before and after the transfer of functions. If the function is transferred to a newly established entity that did not exist prior to the acquisition date, the transfer will also fall within the scope of this Standard if the newly established entity is identified as the acquirer and the newly established entity and the acquiree do not form part of the same economic entity subsequent to the transfer of functions.

A transaction or event undertaken between entities under common control (paragraphs .02(b) and .09)

BC15. A transaction or event in which an acquirer can be identified and that results in a transfer of functions between entities in the same sphere of government, and/or between entities that forms part of the consolidated financial statements, will fall outside the scope of this Standard as the transaction or event is undertaken between entities under common control.

Identifying the acquirer

BC16. IFRS 3 concludes that a new entity formed to effect a business combination is not necessarily the acquirer. If a new entity is formed to exchange equity interests to effect a business combination, one of the combining entities that existed before the business combination shall be identified as the acquirer. In contrast, a new entity that transfers cash or other assets or incurs liabilities as consideration may be the acquirer.

BC17. The Board concluded that this is not likely to occur for a transfer of functions that involves the acquisition of another entity or a transfer of assets and liabilities undertaken between entities not under common control in the public sector. The guidance was therefore excluded from this Standard.

Recognition and measuring the difference between identifiable assets acquired or received, liabilities assumed, any non-controlling interests and the consideration transferred (if any)

BC18. IFRS 3 requires the recognition and measurement of goodwill, i.e. any excess of the purchase consideration paid over the fair value of the assets acquired or received,

liabilities assumed and any non-controlling interests. Goodwill is recognised as an asset and is subject to an annual impairment test.

- BC19. For an item to meet the definition of an asset in the Conceptual Framework, future economic benefits or service potential should be obtainable from that item. In applying that principle to any excess of the purchase consideration paid over the fair value of the assets acquired and received, liabilities assumed, and any non-controlling interests received, the Board noted that the acquirer 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 acquiree 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, and because the excess is likely to have been paid for policy reasons, the Board further argued that it will be more appropriate to recognise the excess as an expense. The Board further noted that in determining the fair value of the assets acquired and received, liabilities assumed and any non-controlling interests received, the assets' or liabilities' future economic benefits or service potential will be reflected in the value determined on acquisition date.
- BC20. Based on the above arguments, the Board concluded that, because the excess of the purchase consideration paid (if any) over the fair value of the assets acquired or received, liabilities assumed and any non-controlling interests can be seen as a premium that is paid by the acquirer to the previous owners, and because the definition of an asset or liability in terms of the Conceptual Framework has not been met to support the recognition of goodwill, the excess should be recognised in surplus and deficit on acquisition date. The entity should however recognise and measure all assets acquired or received and liabilities assumed, subject to it meeting the definition of an asset and liability in the Conceptual Framework and the recognition criteria in the applicable Standards of GRAP before recognising the excess in the statement of financial performance.
- BC21. Respondents to the Exposure Draft supported this proposal, and this Standard requires that the excess should be recognised in surplus and deficit on acquisition date.

Measurement period

- BC22. This Standard provides the acquirer with a reasonable period after the transfer date, a measurement period, during which to obtain the information necessary to identify and measure the assets acquired or received, liabilities assumed and any non-controlling interests in a transfer of functions. The Board agreed to a measurement period of two years.

Effective settlement of a pre-existing relationship between the acquirer and acquiree in a transfer of functions

- BC23. The settlement of a pre-existing relationship between the acquirer and the acquiree is not part of the transfer of functions as these transactions were entered into, by, or on behalf of the acquirer or primarily for the benefit of the acquirer rather than primarily for the benefit of the acquiree before a transfer of functions. Such transactions should be accounted for in terms so the applicable Standards of GRAP.
- BC24. As these transactions were entered into in at arm's length, the acquirer should measure the gain or loss when settling the pre-existing relationship, at its fair value.

Bargain purchases

- BC25. IFRS 3 establishes principles and requirements for the accounting of bargain purchases, i.e. a business combination where the fair value of the assets acquired or received, liabilities assumed and any non-controlling interests exceeds the consideration transferred to the acquiree. IFRS 3 requires that any such gain shall be recognised in surplus or deficit on acquisition date.
- BC26. In its decision to develop this Standard undertaken by way of an exchange and non-exchange transaction, the Board acknowledged that the initial recognition and measurement principles of transfer of functions between entities not under common control undertaken by way of a non-exchange transaction, should be similar to those of business combinations that falls within the scope of IFRS 3. The bargain purchase principles, as included in IFRS 3, should therefore be applied to a transfer of function between entities not under common control undertaken by way of a non-exchange transaction. Any difference between the fair value of the assets acquired or received, liabilities assumed, any non-controlling interest and the consideration transferred (if any) to the acquiree should be recognised in surplus of deficit on the acquisition date. The principle for the treatment of the any excess of the fair value of the assets acquired or received, liabilities assumed any non-controlling interest in a non-exchange transaction, is similar to that in an exchange transaction (see paragraphs BC18. and BC19.). This proposal was supported by respondents to the Exposure Draft.

Revisions following the approval of IPSAS 40 on *Public Sector Combinations*

- BC27. When the Board developed GRAP 106 during 2010, no equivalent International Public Sector Accounting Standard existed. The Board considered IFRS 3 on *Business Combinations*. The International Public Sector Accounting Standards Board issued IPSAS 40 on *Public Sector Combinations* during 2017. During 2022, the Board undertook a project to compare the principles in IPSAS 40 with that in the local Standards. The objective of the review was to identify any similarities and differences between IPSAS 40 and the local Standards.
- BC28. The principles in IPSAS 40 relating to an acquisition were compared to GRAP 106. Both Standards provides guidance in accounting for a transaction or event that

occurs between entities not under common control, and in both Standards, the acquisition-method of accounting is applied to account for the transaction or event.

- BC29. The Board agreed to retain the format of the local guidance, i.e. three separate Standards of GRAP. This is because preparers find it easier to apply the appropriate Standard based on the nature of the transaction or event, and because no substantive implementation issues have been raised by stakeholders.
- BC30. Based on the outcome of the review, the Board agreed that GRAP 106 should be revised by including additional, authoritative guidance from IPSAS 40, where applicable. The Board also agreed that any additional guidance in GRAP 106, that is not included in IPSAS 40, should be retained if it remains relevant. Any amendments to IFRS 3, that were issued subsequent to IPSAS 40 being issued, should be included in GRAP 106.
- BC31. The amendments to IFRS 3 follows a post-implementation review of IFRS 3 where it was noted that entities find it difficult to assess:
- (a) if the processes acquired, are sufficient to constitute one of the elements required for an acquired set of activities and assets to be a business, and if any missing processes are so significant that the set is not a business; and
 - (b) how to apply the definition of a business if the acquired set of activities and assets does not generate revenue.
- BC32. The review also highlighted that the definition of a business was broad and IFRS 3 had no guidance to identify when an acquired set of activities and assets is not a business. As a result, IFRS 3 clarified the definition of a business to determine if a transaction should be accounted for as a business combination or as an asset acquisition. Guidance was also included to clarify that, to be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs. An optional concentration test was also added that permits a simplified assessment of whether an acquired set of activities and assets is a business.
- BC33. When the IASB updated the reference to the new Conceptual Framework for Financial Reporting during May 2020, it also clarified the requirements for liabilities, contingent liabilities and contingent assets. These amendments are also included in this Standard.

Treatment of goodwill

- BC34. IPSAS 40 requires the recognition of goodwill as of the acquisition date, measured as the excess of the consideration transferred, the amount of any non-controlling interest in the acquired operation, and the net of the acquisition date amounts of the identifiable asset acquired or received, liabilities assumed, and any non-controlling interests. Goodwill is recognised to the extent that the acquisition results in the generation of cash flows, or a reduction in the net cash outflows of the acquirer. Any



additional excess is recognised as a loss. IPSAS 40 also provides guidance for a bargain purchase where the net amount of the identifiable assets acquired or received, liabilities assumed and any non-controlling interests exceed the consideration paid. In a bargain purchase, the resulting gain is recognised in surplus or deficit.

- BC35. In updating this Standard with the principles in IPSAS 40, the Board reconsidered its previous conclusion on the treatment of the excess where it was agreed to depart from IFRS 3 on the treatment of goodwill (see BC.18 to BC.21 and BC.25 and BC.26).
- BC36. The Board concluded that the arguments to not recognise the excess as goodwill, remain relevant, specifically because from a local perspective, the excess is seen as a premium that is paid by the acquirer to the previous owners. The Board also concluded that, even though the excess may meet the definition of an asset, the entity may not be able reliably measure the goodwill.

Measurement period

- BC37. IPSAS 40 allows a one year measurement period, whereas GRAP 106 (2010) allowed for a measurement period of two years. The Board agreed to retain a two year measurement period in this Standard, as from practical experience it was observed that entities need more than one year to obtain the necessary information to identify and measure the assets acquired or received, liabilities assumed and any non-controlling interests in the transfer of functions.

Comparison between the International Public Sector Accounting Standard on *Public Sector Combinations* (January 2017)

This Standard is drawn primarily from the International Public Sector Accounting Standard on *Public Sector Combinations* (IPSAS 40). The main differences between this Standard and IPSAS 40 are as follows:

- The heading and related text of this Standard were amended from “public sector combination” to “transfer of functions”.
- Definitions and explanatory guidance from other Standards of GRAP were included as part of this Standard where they are relevant to the understanding of this Standard.
- Guidance to explain when the transaction or event is a transfer of functions not under common control was included in this Standard to clarify the application of this Standard.
- A diagram and related text explaining the distinction between a transfer of functions under common control, a transfer of functions not under common control and a merger have been included to assist entities in determining if this Standard should be applied in accounting for a transaction or event that involves a transfer of functions or merger.
- The guidance in IPSAS 40 to conclude if a combination should be accounted for as an amalgamation or acquisition was omitted.
- Additional guidance is included in this Standard explaining that the terms and conditions of a binding arrangement should be considered to identify the acquirer, the acquiree, the assets and/or liabilities and any non-controlling interests. IPSAS 40 does not include similar guidance.
- Additional explanatory guidance on the concept of residual interest from GRAP 104 has been included in this Standard.
- Any related application guidance that is included as an appendix to IPSAS 40, has been included as part of the text of this Standard, where appropriate.
- The treatment of goodwill is dealt with differently in this Standard. This Standard requires that the excess of the purchase consideration paid (if any) over the fair value of the assets acquired or received and/or liabilities assumed, should be recognised in surplus and deficit. IPSAS 40 requires that goodwill be recognised as an asset.
- The measurement period in of two years in GRAP 106 (2010) was retained due to practical considerations. IPSAS 40 only permits a year.
- Illustrative examples from IPSAS 40 that are not relevant have not been included in this Standard.



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- Guidance from IFRS 3 on the elements of a function, the optional test to identify concentration of fair value, assessing whether a transferred process is substantive, and exceptions to the recognition principle relating to liabilities and contingent liabilities have been included in this Standard.
- The transitional provisions to this Standard are dealt with differently than in IPSAS 40.