ACCOUNTING STANDARDS BOARD

STANDARD OF GENERALLY RECOGNISED ACCOUNTING PRACTICE

TRANSFER OF FUNCTIONS BETWEEN ENTITIES NOT UNDER COMMON CONTROL

(GRAP 106)

Issued by the
Accounting Standards Board

November 2010

Acknowledgement

This Standard of Generally Recognised Accounting Practice (GRAP) on *Transfer of Functions Between Entities Not Under Common Control* is drawn primarily from the International Financial Reporting Standard (IFRS® Standard) 3 on *Business Combinations* issued by the International Accounting Standards Board (IASB®). The IASB has issued a comprehensive body of IFRS® Standards and IFRIC® Interpretations. Extracts of the IFRS Standard 3 on *Business Combinations* are reproduced in this Standard of GRAP with the permission of the IASB.

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Standard of Generally Recognised Accounting Practice

Transfer of Functions Between Entities Not Under Common Control

TRANSFER OF FUNCTIONS BETWEEN ENTITIES NOT UNDER COMMON CONTROL

This Standard was originally issued by the Accounting Standards Board (the Board) in November 2010. Since then, it has been amended by:

- Consequential amendments following the revisions to GRAP 100 *Discontinued Operations* in 2013.
- The transitional provisions for the initial adoption of GRAP 105 *Transfers of Functions Between Entities Under Common Control*, GRAP 106 *Transfers of Functions Between Entities Not Under Common Control* and GRAP 107 *Mergers* amended as a result of the amendments to the Directives made in March 2016.
- Improvements to the Standards of GRAP, issued by the Board in November 2017.
- Consequential amendments when the following Standards of GRAP became effective:
    - GRAP 35 *Consolidated Financial Statements*
    - GRAP 37 *Joint Arrangements*

Introduction

This pronouncement is set out in paragraphs .01 to .101B. 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 accounting principles for the acquirer in a transfer of functions between entities not under common control.

Scope

.02 An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard to a transaction or other event that meets the definition of a transfer of functions.

.03 This Standard does not apply to:

(a) transfers of individual or groups of assets and/or liabilities that do not meet the definition of a transfer of functions (see the applicable Standard of GRAP).

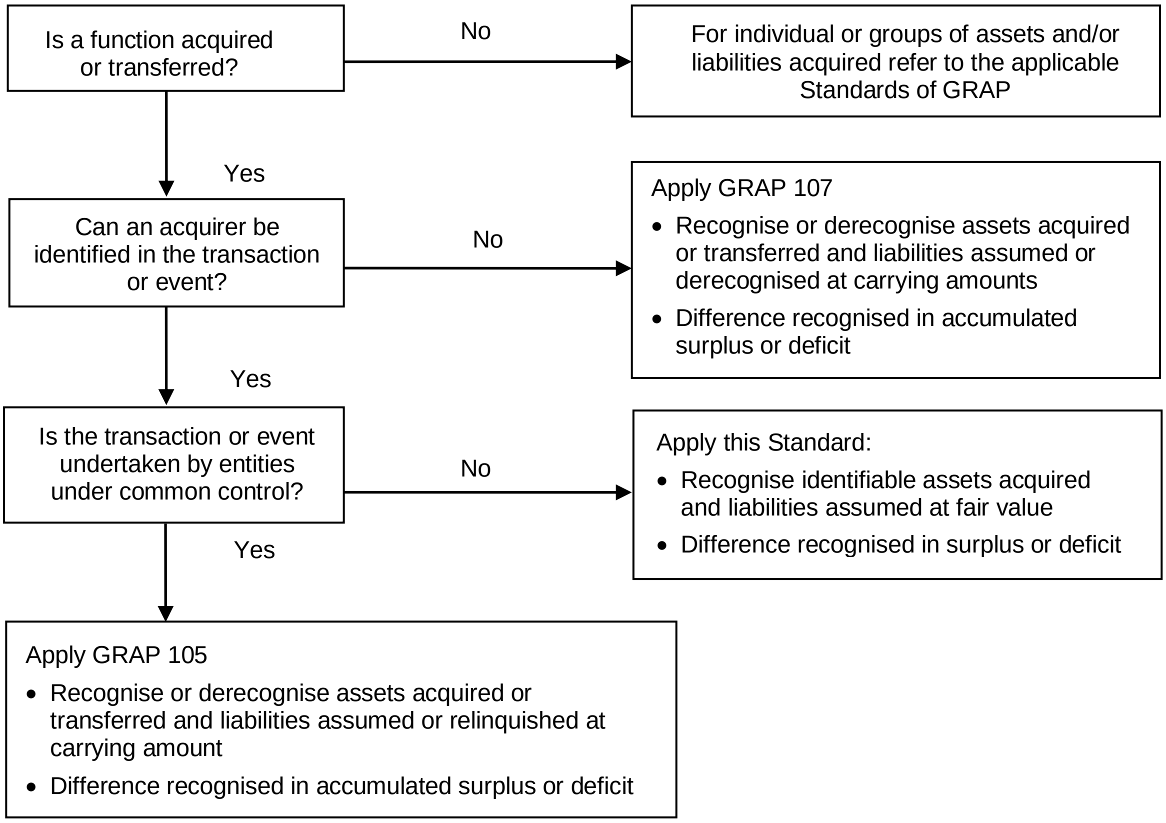
(b) a transfer of functions undertaken between entities under common control (see the Standard of GRAP on *Transfer of Functions Between Entities Under Common Control* (GRAP 105));

(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.

.04 A transfer of functions undertaken between entities not under common control could involve an acquisition or transfer of another entity or the acquisition 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 Transfers of individual or groups of assets and/or liabilities are excluded from the scope of this Standard as these arrangements result in the acquisition of an asset or a group of assets 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 from time to time, 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 <u>acquiree</u> is the entity and/or the functions that the acquirer obtains control of in a transfer of functions.

An <u>acquirer</u> is the entity that obtains control of the acquiree or transferor.

<u>Acquisition date</u> is the date on which the acquirer obtains control of the acquiree.

A <u>binding arrangement</u> 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.

<u>Contingent consideration</u> 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.

<u>Control</u> is the power to govern the financial and operating policies of another entity so as to obtain benefit from its activities.

<u>Fair value</u> 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 <u>function</u> is an integrated set of activities that is capable of being conducted and managed for purposes of achieving an entity's objectives, either by providing economic benefits or service potential.

An asset is <u>identifiable</u> 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, asset or liability; 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 <u>merger</u> 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.

<u>Non-controlling interest</u> 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

.10A 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

.11 For a transaction or event to occur between entities under common control, the transaction or event needs to be undertaken 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 education department. Because the 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.

.12 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

.13 A function is an integrated set of activities that is capable of being conducted and managed for purposes of achieving an entity's objectives, either by providing economic benefits or service potential. 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. Although functions may have outputs, outputs are not required to qualify as a function. The three elements of a function are defined as follows:

(a) **Input:** Any resource that creates, or has the ability to create, 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 or has the ability to create outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but 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. This may be in the form of achieving service delivery objectives, or the delivery of goods and/or services.

.14 However, to be capable of being conducted and managed for the purposes defined, a function requires two essential elements — inputs and processes applied to those inputs, which together may or will be used to create outputs. However, a function need not include all of the inputs or processes that will be used in operating that function if entities are capable of acquiring the function and continuing to produce outputs, for example, by integrating the function with their own inputs and processes.

.15 The nature of the elements of a function varies 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.

.16 A function in the development stage might not have outputs. If not, other factors should be considered to determine whether the integrated set of activities meets the definition of a function. Those factors include, but are not limited to, whether the function:

(a) has begun planned principal activities;

(b) has employees, intellectual property and other inputs and processes that could be applied to those inputs;

(c) is pursuing a plan to produce outputs; or

(d) will be able to obtain access to economic benefits or service potential.

Not all of those factors need to be present in the development stage to meet the definition of a function.

Residual interest

.17 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.

.18 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

.19 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 and liabilities assumed constitute a function. If the assets acquired or liabilities assumed are not a function, the reporting entity shall account for the transaction or other event as in accordance with the applicable Standard of GRAP.

.20 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.

.21 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 transferred 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

.22 An entity shall account for each transfer of functions between entities not under common control by applying the acquisition method.

.23 Applying the acquisition method requires:

(a) identifying the acquirer;

(b) determining the acquisition date;

(c) recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and

(d) recognising the difference between (c) and the consideration transferred to the seller.

Identifying the acquirer

.24 For each transfer of functions between entities not under common control,

one of the combining entities shall be identified as the acquirer.

.25 The terms and conditions of a transfer of functions undertaken 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.

.26 In a transfer of functions effected primarily by transferring cash or other assets (where applicable) or by incurring liabilities, the acquirer is usually the entity that transfers the cash or other assets (where applicable) or incurs the liabilities.

.27 In a transfer of functions effected primarily by exchanging residual interests, the acquirer is the entity that does not experience a change in control.

.28 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.

.29 Determining the acquirer shall 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

.30 The acquirer shall identify the acquisition date, which is the date on which it obtains control of the acquiree.

.31 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 the functions is the date on which the acquirer transfers the consideration (if any), acquires the assets and assumes the liabilities of the acquiree as identified to in the binding arrangement. However, the acquirer may obtain control on a date that is either earlier or later than the date on which the assets and liabilities are transferred by the acquiree, or specified in the binding arrangement. 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 shall consider all relevant facts and circumstances in identifying the acquisition date.

.32 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 and liabilities of the function to be transferred.

Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

Recognition principle

.33 As of the acquisition date, the acquirer shall recognise, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree. Recognition of identifiable assets acquired and liabilities assumed is subject to the conditions specified in paragraphs .34 to .36.

Recognition conditions

.34 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the *Framework for the Preparation and Presentation of Financial Statements*[2] 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.

.35 In addition, to qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must be part of what the acquirer and the acquiree (or its former owners) agreed in the binding arrangement rather than the result of separate transactions. The acquirer shall apply the guidance in paragraphs .77 to .83 to determine which assets acquired or liabilities assumed 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.

[2] 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*.

.36 The acquirer's application of the recognition principle and conditions may result in recognising some assets and liabilities that the acquiree had not previously recognised as assets and liabilities in its financial statements. For example, the acquirer recognises the acquired identifiable intangible assets, such as a brand name, a patent or a customer relationship, that the acquiree did not recognise as assets in its financial statements because it developed them internally and charged the related costs to expense.

.37 Paragraphs .38 to .44 provide guidance on recognising operating leases and intangible assets. Paragraphs .56 to .60 specify the types of identifiable assets and liabilities that include items for which this Standard provides limited exceptions to the recognition principle and conditions.

Operating leases

.38 The acquirer shall recognise no assets or liabilities related to an operating lease in which the acquiree is the lessee except as required by paragraphs .39 and .40.

.39 The acquirer shall determine whether the terms of each operating lease in which the acquiree is the lessee are favourable or unfavourable. The acquirer shall 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 .54 provides guidance on measuring the acquisition-date fair value of assets subject to operating leases in which the acquiree is the lessor.

.40 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

.41 The acquirer shall separately recognise the identifiable intangible assets acquired in a transfer of functions. An intangible asset is identifiable if it meets either the separability criterion or the contractual-legal right criterion.

.42 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 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.

.43 The separability criterion means that an acquired 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 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 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, customer lists are frequently licensed and thus meet the separability criterion. Even if an acquiree believes its customer lists have characteristics different from other customer lists, the fact that customer lists are frequently licensed generally means that the acquired customer list meets the separability criterion. However, a customer list acquired 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 customers.

.44 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 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.

Classifying or designating identifiable assets acquired and liabilities assumed in a transfer of functions

.45 ***At the acquisition date, the acquirer shall classify or designate the identifiable assets acquired and liabilities assumed as necessary to 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.***

.46 In some situations, Standards of GRAP provide for different accounting depending on how an entity classifies or designates a particular asset or liability. Examples of classifications or designations that the acquirer shall 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 liabilities as a financial asset 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.

.47 An exception to the requirement in paragraph .45 to the classification or designation of the assets acquired and liabilities assumed on the acquisition date, is that the acquirer shall classify the following contracts on the basis of the contractual 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):

(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.

Measurement principle

.48 ***The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date fair values.***

Non-controlling interest in an acquiree

.49 For each transfer of functions, the acquirer shall 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 shall be measured at their acquisition-date fair values, unless another measurement basis is required by the Standards of GRAP.

.50 Sometimes an acquirer will be able to measure the acquisition-date fair value of a non-controlling interest on the basis of active market prices for the equity shares not held by the acquirer. In other situations, however, an active market price for the equity shares will not be available. In those situations, the acquirer would measure the fair value of the non-controlling interest using other valuation techniques.

.51 The fair values of the acquirer's interest in the acquiree and the non-controlling interest on a per-share basis might differ. The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree or, conversely, the inclusion of a discount for lack of control (also referred to as a minority discount) in the per-share fair value of the non-controlling interest.

.52 Paragraphs .53 and .54 provide guidance on measuring the fair value of particular identifiable assets. Paragraphs .56 to .63 specify the types of identifiable assets and liabilities that include items for which this Standard provides limited exceptions to the recognition or measurement principle.

Assets with uncertain cash flows (valuation allowances)

.53 The acquirer shall not recognise a separate valuation allowance as of the acquisition date for assets acquired 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 receivables, including loans, at their acquisition-date fair values, the acquirer does not recognise a separate valuation allowance for the contractual cash flows that are deemed to be uncollectible at that date.

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

.54 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 shall take into account the terms of the lease. In other words, the acquirer does not recognise a separate asset or liability if the terms of an operating lease are either favourable or unfavourable when compared with market terms for leases in which the acquiree is the lessor.

Exceptions to the recognition or measurement principles

.55 This Standard provides limited exceptions to its recognition and measurement principles. Paragraphs .56 to .63 specify both the particular items for which exceptions are provided and the nature of those exceptions. The acquirer shall account for those items by applying the requirements in paragraphs .56 to .63, which will result in some items being:

(a) Recognised either by applying recognition conditions in addition to those in paragraphs .34 and .35 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

.56 The Standard of GRAP on *Provisions, Contingent Liabilities and Contingent Assets* (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.

.57 The requirements in GRAP 19 do not apply in determining which contingent liabilities to recognise as of the acquisition date. Instead, the acquirer shall 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, the acquirer recognises a contingent liability assumed in a transfer of functions 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 .86 provides guidance on the subsequent accounting for contingent liabilities.

Exceptions to both the recognition and measurement principles

Employee benefits

.58 The acquirer shall recognise and measure a liability (or asset, if any) related to the acquiree's employee benefit arrangements in accordance with the Standard of GRAP on *Employee Benefits*.

Indemnification assets

.59 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 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 shall 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 or a liability that is recognised at the acquisition date and measured at its acquisition-date fair value, the acquirer shall 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 .53 provides related guidance).

.60 In some circumstances, the indemnification may relate to an asset or a liability that is an exception to the recognition or measurement principles. Alternatively, an indemnification may relate to an asset 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 shall 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 .87 provides guidance on the subsequent accounting for an indemnification asset.

Exceptions to the measurement principle

Reacquired rights

.61 The acquirer shall measure the value of a reacquired right recognised as an intangible asset on the basis of the remaining contractual term of the related contract or other binding arrangement regardless of whether market participants would consider potential renewals of the contract or other binding arrangement in determining its fair value. Paragraphs .62 and .63 provide related guidance.

.62 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. 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 .61 provides guidance on measuring a reacquired right and paragraph .85 provides guidance on the subsequent accounting for a reacquired right.

.63 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 shall recognise a settlement gain or loss. Paragraph .81 provides guidance for measuring that settlement gain or loss.

Recognising and measuring the difference between the assets acquired and liabilities assumed and the consideration transferred (if any)

.64 The acquirer shall recognise the difference between the assets acquired and liabilities assumed 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 .65);

(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 .69 and .70), the acquisition-date fair value of the acquirer's previously held equity interest in the acquiree.

(b) The net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed measured in accordance with this Standard.

Consideration transferred

.65 The consideration transferred in a transfer of functions shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree and the residual interests issued by the acquirer. 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.

.66 The consideration transferred may include assets or liabilities 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 shall remeasure the transferred assets or liabilities 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 or liabilities remain within the combined entity after the transfer of function (for example, because the assets or liabilities were transferred to the acquiree rather than to its former owners), and the acquirer therefore retains control of them. In that situation, the acquirer shall measure those assets and liabilities at their carrying amounts immediately before the acquisition date and shall not recognise a gain or loss in surplus or deficit on assets or liabilities it controls both before and after the transfer of functions.

Contingent consideration

.67 The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement (see paragraph .65). The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

.68 The acquirer shall 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 shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph .88 provides guidance on the subsequent accounting for contingent consideration.

A transfer of functions achieved in stages

.69 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 acquisition.

.70 In a transfer of functions achieved in stages, the acquirer shall 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 shall be recognised on the same basis as would be required if the acquirer had disposed directly of the previously held residual interest.

Measurement period

.71 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 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 and liabilities 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.

.72 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 reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirements of this Standard:

(a) the identifiable assets acquired, liabilities assumed and any non-controlling interest 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 acquired and liabilities assumed.

.73 The acquirer shall 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.

.74 The acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset (liability) by means of decreasing (increasing) the excess of the purchase consideration paid (if any) over the fair value of the assets acquired and liabilities assumed 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 or liability. 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 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 of deficit resulting from a change to the provisional amount recognised for the claim receivable from the insurer.

.75 During the measurement period, the acquirer shall 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 shall 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.

.76 After the measurement period ends, the acquirer shall 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

.77 The acquirer and the acquiree may have a pre-existing relationship or other arrangement 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. In either situation, the acquirer shall identify any amounts that are not part of what the acquirer and the acquiree (or its former owners) exchanged in the transfer of functions. The acquirer shall recognise as part of applying the acquisition method only the consideration transferred (if any) for the acquiree and the assets acquired and liabilities assumed 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 .80 and .81, separate transactions shall be accounted for in accordance with the applicable Standards of GRAP.

.78 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 .79 to .82 provide related guidance.

.79 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 for the transaction may provide insight into whether it is part of the consideration transferred, if any, and the assets acquired or transferred or liabilities assumed or relinquished. For example, amounts due by the acquiree from a previous arrangement between the acquiree as a service provided will not form part of the transfer of functions as the services provided were primarily for the benefit of the acquiree rather for the benefit of the acquirer.

(b) **The timing of the transaction** — The timing of the transaction may also provide insight into whether it is part of the consideration, if any, for the acquiree.

Effective settlement of a pre-existing relationship between the acquirer and acquiree in a transfer of functions (application of paragraph .78(a))

.80 A pre-existing relationship between the acquirer and acquiree may be contractual (for example, vendor and customer or supplier) or non-contractual (for example, plaintiff and defendant).

.81 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, 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 contract 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 or liability, and the reported gain or loss therefore may differ from the amount calculated by applying the above requirements.

.82 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 .81.

Acquisition-related costs

.83 Acquisition-related costs are costs the acquirer incurs to effect a transfer of functions. Those costs include advisory, legal, accounting, valuation and other professional or consulting fees, general administrative costs, and costs of registering and issuing debt and equity securities (if applicable). The acquirer shall 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) shall be recognised in accordance with GRAP 104.

Subsequent measurement and accounting

.84 In general, an acquirer shall subsequently measure and account for assets acquired, 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, 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.

Reacquired rights

.85 A reacquired right recognised as an intangible asset shall be amortised over the remaining contractual period of the contract in which the right was granted. An acquirer that subsequently sells a reacquired right to a third party shall include the carrying amount of the intangible asset in determining the gain or loss on the sale.

Contingent liabilities

.86 After initial recognition and until the liability is settled, cancelled or expires, the acquirer shall 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

.87 At the end of each subsequent reporting period, the acquirer shall measure an indemnification asset that was recognised at the acquisition date on the same basis as the indemnified liability 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 shall derecognise the indemnification asset only when it collects the asset, sells it or otherwise loses the right to it.

Contingent consideration

.88 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. 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 shall 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 shall not be remeasured and its subsequent settlement shall be accounted for within net assets.

(b) Other contingent consideration that:

(i) is 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 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.

.89 Examples of other Standards of GRAP that provide guidance on subsequently measuring and accounting for assets acquired and liabilities assumed or incurred in a transfer of functions include:

(a) The Standard of GRAP on *Intangible Assets* prescribes the accounting for identifiable intangible assets acquired in a transfer of functions.

(b) The IFRS Standard(s) on insurance provides guidance on the subsequent accounting for an insurance contract acquired 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.

Disclosures

.90 ***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.

.91 ***To meet the objective in paragraph .90, 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.

(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 determining 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 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 and liabilities assumed.

(i) Additional contingent liabilities and contingent assets assumed or acquired in the transfer of functions.

(j) For transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the transfer of functions in accordance with paragraph .77:

(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.

(k) 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. The amount of any issue costs not recognised as an expense and how they were recognised shall also be disclosed.

(l) For each transfer of function in which the acquirer holds less than 100 per cent of the equity 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 techniques and key model inputs used for determining that value.

(m) 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 .70) and the line item in the consolidated statement of financial performance in which that gain or loss is recognised.

(n) The following information:

(i) the amounts of revenue and surplus or deficit of the acquiree since the acquisition date; and

(ii) the revenue and surplus or deficit of the combined entity 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 paragraph is impracticable, the acquirer shall disclose that fact and explain why the disclosure is impracticable. This Standard uses the term "impracticable" with the same meaning as in GRAP 3.

.92 The acquirer shall disclose the difference between the assets acquired and liabilities assumed and the consideration transferred (if any), as a separate line item in the statement of financial performance.

.93 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 .91(e) to (n).

.94 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.

.95 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 .71) for particular assets, liabilities, non-controlling interests or any consideration and the amounts recognised in the financial

statements for the transfer of functions thus have been determined:

(i) the reasons why the initial accounting for the transfer of functions is incomplete;

(ii) the assets, liabilities, residual interest or 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 .75.

(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 liabilities assumed 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 combined entity's financial statements.

.96 If the specific disclosures required by this and other Standards of GRAP do not meet the objectives set out in paragraphs .91 and .95, the acquirer shall disclose whatever additional information is necessary to meet those objectives.

Transitional provisions

Initial adoption of the Standards of GRAP

.97 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.

Amendments to Standards of GRAP

.98 ***Paragraphs .100 and .101 were amended to allow entities to continue applying the relief provided for the measurement of assets and liabilities acquired in a transfer of function between entities not under common control before the effective date of this Standard. These amendments are effective from 1 April 2015.***

.98A ***Paragraphs .68 and .88 were amended by the Improvements to the Standards of GRAP issued in April 2017. An entity shall apply these amendments prospectively to transfer of functions between entities not under common control for which the acquisition date is on or after 1 April 2018. Earlier application is encouraged. If an entity elects to apply these amendments earlier, it shall disclose this fact.***

Effective date

Initial adoption of the Standards of GRAP

.99 ***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.***

.100 ***An entity is not required to apply the measurement period in paragraphs .71 to .76 if it has entered into a transfer of functions between entities not under common control before the effective date of this Standard.***

.101 The guidance on the measurement period as included in paragraphs .71 to .76 will only become effective once the Directives on *Transitional Provisions for Public Entities, Trading Entities, Municipal Entities, Public Technical and Vocational Education and Training Colleges, and Constitutional Institutions (*Directive 2), *Transitional Provisions for High Capacity Municipalities* (Directive 3) and *Transitional Provisions for Medium and Low Capacity Municipalities and Trading Entities* (Directive 4) that prescribe the transitional provisions for entities on the initial adoption of the Standards of GRAP are withdrawn. Directives 2 to 4 permitted a three year measurement period on the initial adoption of the Standards of GRAP. An entity that has entered into a transfer of functions between entities not under common control prior to the effective date of this Standard, may continue to apply the three year measurement period.

Entities already applying Standards of GRAP

.101A ***Paragraphs .02, .10, .25 and .89 were amended and paragraph .10A was added by GRAP 35 issued March 2017. An entity shall apply these amendments prospectively for annual financial periods beginning on or after***

1 April 2020. If an entity elects to apply these amendments earlier, it shall disclose this fact.

.101B Paragraph .03 is amended by the Standard of GRAP on Joint Arrangements issued March 2017. An entity shall apply this amendment retrospectively for annual financial periods beginning on or after 1 April 2020. If an entity elects to apply this amendment earlier, it shall disclose this fact.

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.

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 .03(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 .03(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 .03(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 and liabilities assumed, 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 and liabilities assumed. 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 *Framework for the Preparation and Presentation of Financial Statements*[2], 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 liabilities assumed, 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 liabilities assumed, 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 and liabilities assumed 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 *Framework for the Preparation and Presentation of Financial Statements*[2] 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 and liabilities assumed, subject to it meeting the definition of an asset and liability in the *Framework for the Preparation and Presentation of Financial Statements*[2] 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 identity and measure the assets acquired and liabilities assumed 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 and liabilities assumed 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 and liabilities assumed, 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 and liabilities assumed 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.

Comparison with the International Financial Reporting Standard on *Business Combinations* (2008)

This Standard is drawn primarily from IFRS 3. The main differences between this Standard and IFRS 3 are as follows:

- The heading and related text of this Standard has been amended from "business combinations" to "transfer of functions between entities not under common control" to reflect public sector circumstances.
- The objective paragraph in this Standard has been simplified and aligned with that of other Standards of GRAP.
- The scope of this Standard has been expanded to exclude other public sector specific transactions. A diagram has been included to assist entities in determining whether this Standard should be applied in accounting for a transaction or event that involves a transfer of functions or merger.
- Guidance on the concept of common control has been included in this Standard to clarify the application of this Standard in the public sector.
- Additional explanatory guidance on the concept of residual interest from GRAP 104 has been included in this Standard.
- The term "service potential" has been used in this Standard as public entities' activities give rise to both economic benefits and service potential.
- Public sector definitions and explanatory guidance from other Standards of GRAP have been included in this Standard where they are relevant to the understanding of this Standard.
- Any related application guidance that is included as an appendix to IFRS 3, has been included as part of the text of this Standard, where appropriate.
- Additional explanatory guidance on identifying an acquirer and in determining the acquisition date has been included in this Standard.
- An example has been included to clarify the acquisition date from a public sector perspective.
- Certain exceptions to the recognition and/or principles have been excluded from this Standard. This Standard requires that all identifiable assets and liabilities that meet the definition in the *Framework for the Preparation and Presentation of Financial Statements*[2] and the recognition criteria in the applicable Standard of GRAP are recognised in the transfer of functions.
- 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 and liabilities assumed, should be recognised in surplus and deficit.

- As this Standard includes in its scope transactions or events undertaken in terms of an exchange and non-exchange transaction, the related text in this Standard has been expanded to incorporate this concept.
- The measurement period in IFRS 3 that allows the acquirer additional time to recognise assets acquired and liabilities assumed in a business combination, has been extended to two years due to practical considerations.
- Only factors assisting the acquirer to determine whether a transaction is part of the transfer of functions or whether the transaction is separate from the transfer of functions that are relevant to the public sector, have been included in this Standard.
- The appendix on the illustrative examples in IFRS 3 has not been included in this Standard, as most of the examples address circumstances that are not applicable to this Standard.
- The transitional provisions to this Standard are dealt with differently than in IFRS 3.