AT THE GLIMPSE

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Ministry of Finance
Accountant General's Department of Malaysia

MPSAS 40 Summary – *Public Sector Combinations*

This summary provide an overview of MPSAS 40, Public Sector Combinations

Objective

The purpose of this standard is to establish requirements for classifying, recognizing, and measuring public sector combinations.

Background

Previously, MPSASs did not provide guidance on how to account for public sector combinations. Instead, other MPSASs explained that guidance on accounting for such combinations can be found in the relevant international or national accounting standard.

In the absence of MPSAS dealing with public sector combinations, public sector entities looked initially to International Financial Reporting Standard (IFRS) 3, *Business Combinations or* Malaysian Financial Reporting Standards (MFRS) 3, *Business Combinations.* However, IFRS 3 or MFRS 3 requires all combinations to be accounted for as acquisitions. Public sector entities also looked into International Public Sector Accounting Standards (IPSAS) when IPSASB issued IPSAS 40 – *Public Sector Combinations* in January 2017. IPSAS 40 requires combinations to be accounted for as acquisitions or amalgamations.

History

- Exposure Draft (ED) 37/2021, *Public Sector Combinations* was issued in November 2020 after the approval from Government Accounting Standards Advisory Committee (GASAC) and the [draft] MPSAS 40 reflect the comments received to ED 37/2020.
- *Jawatankuasa Pemandu Perakaunan Akruan* (JKP) approved [draft] MPSAS 40 in October 2021 and IFAC permitted the reproduction of IPSAS 40 in December 2021.
- MPSAS 40 was issued in December 2021.

Why MPSAS 40 different from IFRS 3

IFRS 3 didn't provide appropriate accounting for public sector combinations

In developing IFRS 3, the International Accounting Standards Board (IASB) came to the conclusion that ‘true mergers’ or ‘mergers of equals’ in which none of the combining entities obtain control of the others are so rare as to be virtually non-existent in the private sector. Consequently, the IASB decided that separate accounting requirements for such combinations was not necessary.

In contrast, mergers or amalgamation are the most common form of combination in the public sector. For example the restructuring of federal government ministries, reorganization of local government and nationalization of private sector entity.

MPSAS 40 will enhance consistency and comparability in how public sector combinations are reported by public sector entities and users of financial statement will able to obtain the information needed to evaluate the nature and financial effect of a public sector combination.

Key differences between private and public sector:

- The objective of most business and business combinations is to generate profits.
- Most business combinations arise as a result of exchange transactions whereby consideration is paid to compensated those with an entitlement to the net assets.
- Most business combinations are voluntary.

- The objective of public sector combination is commonly to deliver goods and services for community or social benefit other than to generate profit.
- Public sector combination takes place by way non-exchange transactions whereby no consideration is paid or consideration is paid for the reason other than to compensate those with an entitlement to the net assets.
- A public sector combination may voluntary or may be required by legislation or other authority.

What is the difference with IPSAS 40

MPSAS 40 is drawn primarily from IPSAS 40, Public Sector Combinations from the 2018 Handbook of International Public Sector Accounting Pronouncements of the International Public Sector Accounting Standards Board, published by the International Federation of Accountants (IFAC) with permission from IFAC.

The main differences are that MPSAS 40 refers to MPSAS 25, *Employee Benefits (*in paragraph 35 and 80), whereas IPSAS 40 refers to IPSAS 39, *Employee Benefits.* This paragraph has been changed because MPSAS yet to adopt IPSAS 39, a new standard issued by IPSASB that been superseded IPSAS 25.

In these paragraphs requires resulting entity or acquirer to recognize and measure a liability (or asset, if any) related to the public sector combination's employee benefit arrangement in accordance with MPSAS dealing with employee benefits.

As a result of this change, paragraph 128 of MPSAS 25 associated to assets and liabilities related to post employment benefit in an entity combination has been removed.

Objectives of MPSAS 40

The objective of MPSAS 40 is to improve the relevance, faithful representativeness, and comparability of the information that a reporting entity provides in its financial statements about a public sector combination and its effects

This standard establishes principles and requirements for how :

- A reporting entity classifies a public sector combination as an amalgamation or an acquisition;
- A resulting entity recognizes and measures in its financial statements the identifiable assets received, the liabilities assumed and any non-controlling interest in an amalgamation;
- A resulting entity recognizes and measures components of net assets/equity and other adjustments recognized in an amalgamation;
- An acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation;
- An acquirer recognizes and measures the goodwill acquired in, or the gain or loss arising from, an acquisition; and
- A reporting entity determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of a public sector combination.

Scope and Definitions

Key definitions

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

An operation is an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services.

Scope

*MPSAS 40 applies to a transaction or other event that meets the definition of a **public sector combination**.*

This Standard applies to a transaction or other event that meets the definition of a public sector combination that is bringing together of separate operation into one public sector entity. Thus, a combination that not constitute an operation is not a public sector combination.

Example of public sector combinations:

- Nationalizations
- Reorganizations of local or regional governments
- Transfer of operation from one government to another
- Restructurings of central government ministries

The following is not a public sector combinations:

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

MPSAS 40 also excludes from its scope:

- The accounting for formation of a joint arrangement in the financial statements of the joint arrangement itself; and
- The acquisition by an investment entity, as defined in MPSAS 35, *Consolidated Financial Statements*, of an investment in a controlled entity that is required to be measured at fair value through surplus or deficit.

Classification of Public Sector Combinations

An <u>amalgamation</u> gives rise to a resulting entity and is either:

- *A public sector combination in which no party to the combination gains control of one or more operations; or*
- *A public sector combination in which one party to the combination gains control of one or more operations, and in which there is evidence that the combination has the economic substance of an amalgamation.*

An <u>acquisition</u> is a public sector combination in which one party to the combination gains control of one or more operations, and there is evidence that the combination is not an amalgamation.

In determining the classification of the public sector combination as either an amalgamation or an acquisition, an entity assess whether one party to a public sector combinations gain control of one or more operations as a result of that combinations by applying the principle and guidance in MPSAS 35, Consolidated Financial Statements.

If one party to a public sector combination gains control of one or more operations as a result of the combination, an entity shall consider the economic substance of the combination is not an amalgamation by considering the following indicators:

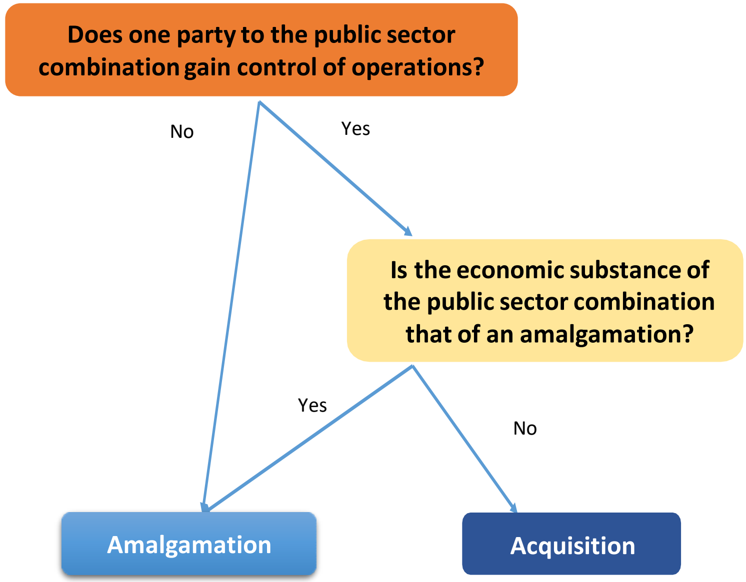
Indicators relating to Consideration

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

Indicators relating to the Decision-Making Process

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

The classification approach is summarized below:



Accounting for Amalgamations

*A resulting entity shall account for each amalgamation by applying the **Modified Pooling of Interests Method** of accounting.*

*A **resulting entity** is the entity that is the result of two or more operations combining in an amalgamation.*

***The modified pooling of interests method** results in a single combined resulting entity. A single uniform set of accounting policies, consistent with the requirements of MPSASs, is adopted by that entity, and the carrying amounts of the identifiable assets and liabilities of the combining operations are adjusted, where required, to conform to those accounting policies.*

Identify the resulting entity → Determining amalgamation date → Recognizing and measuring the identifiable assets received, the liabilities assumed and any non-controlling interest in the combining operations → Recognizing and measuring the components of net assets/equity and other adjustments from an amalgamation

The resulting entity:

- Recognize the identifiable assets, liabilities and any non-controlling interests that are recognized in the financial statements of the combining operations as at the amalgamation date;
- Measure them at their carrying amounts in the financial statements of the combining operations as of the amalgamation date; and
- Adjust the carrying amounts to conform to the resulting entity's accounting policies.

Components of Net Assets/Equity of the resulting entity:

An amalgamation does not give rise to goodwill. Thus, the amounts equal and opposite to the following items will be recognized to the net assets/equity:

- The carrying amounts of the combining operations' assets;
- The carrying amounts of the combining operations' liabilities;
- The carrying amounts of the combining operations' non-controlling interests; and
- Corresponding adjustments from an amalgamation.

Presentation and disclosure

The resulting entity shall disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognized in the current reporting period that relate to amalgamations that occurred in the period or previous reporting periods.

A reporting entity will take into account issues such as:

- What information will be most relevant to the users of the financial statements;
- Whether the reporting entity is a new entity or in substance a new entity; and
- Whether existing reserves of the combining operations (for example, hedging reserves) are required to comply with other MPSASs.

Accounting for Acquisitions

An acquirer shall account for each acquisition by applying the acquisition method of accounting.

*An **acquirer** is the entity that gains control of one or more operations in an acquisition.*

***The acquisition method** views a combination from the perspective of the acquirer—the entity that gains control of the other operations. The acquirer purchases or otherwise gains control over net assets and recognizes in its financial statements the assets acquired and liabilities assumed, including those not previously recognized by the acquired operation.*

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

Identifying the acquirer → **Determining the acquisition date** → **Recognizing and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation** → **Recognizing and measuring goodwill or gain from bargain purchase**

The acquirer:

- Recognize, separately from any goodwill recognized, the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquired operation; and
- Measure the identifiable assets acquired and liabilities assumed at their acquisition-date fair values.

Recognizing and Measuring Goodwill or a Gain from a Bargain Purchase

Goodwill as of the acquisition date measured as the excess of:

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

  <u>over</u>
- The net of the amounts of the identifiable assets acquired and the liabilities assumed.

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

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

The Key Differences between Amalgamations and Acquisitions

	AMALGAMATIONS	ACQUISITIONS
Method	Modified Pooling of Interest	Acquisition
Entity	Resulting Entity	Acquirer
Assets and Liabilities Recognizes	Identifiable assets and liabilities	Identifiable assets and liabilities
Measurement	Carrying Amount	Fair Value
Difference between consideration (if any), assets and liabilities transferred	Recognized in Net Assets/Equity Components not specified	Goodwill/Bargain purchase (consideration)

Consequence Amendments to Other MPSASs

MPSAS effected	Reason of amendment	Para. effected
MPSAS 1 – *Presentation of Financial Statements*	Editorial amendment that replace the word “Entity Combination” to “Public Sector Combination”.	135
MPSAS 14 – *Events After the Reporting Date*	Include disclosure requirement of Non Adjusting Event resulting from PSC.	13
MPSAS 16 – *Investment Property*	Include requirement of MPSAS 40 when making a judgment in acquisition of investment property and respective disclosure requirement of the acquisition through PSC.	18A, 87 & 90
MPSAS 17 – *Property, Plant & Equipment*	Additional disclosure requirement when addition of PPE acquired through PSC.	60 & 88
MPSAS 19 – *Provisions, Contingent Liabilities and Contingent Assets*	Exclude in the scope of MPSAS 19 when there is a contingent consideration of an acquirer in PSC that within the scope of MPSAS 40.	4A
MPSAS 21 – *Impairment of Non-Cash-Generating Assets*	Amendment to the definition of cash-generating-assets that include goodwill arising from PSC.	14 & 20A
MPSAS 23 – *Revenue from Non-Exchange Transactions*	Editorial amendment that replace the word “Entity Combination” to “Public Sector Combination”.	1, 2 & 6
MPSAS 25 – *Employee Benefits*	▪ Editorial amendment that replace the word “Entity Combination” to “Public Sector Combination”. ▪ Removal of paragraph that relates to Entity Combinations because it has been covered in MPSAS 40.	128, 141 & IE7

Consequence Amendments to Other MPSASs (Cont'd)

MPSAS effected	Reason of amendment	Para. effected
MPSAS 26 – *Impairment of Cash-Generating Assets*	Include in the scope and additional requirement of goodwill that result from PSC and the respective additional disclosures.	2, 7, 18A, 20A, 23B, 71, 76, 88, 90A-O, 91, 97A-H, 98, 111, 111A, 111B, 123 & 124
MPSAS 27 - *Agriculture*	Editorial amendment that replace the word "Entity Combination" to "Public Sector Combination".	48
MPSAS 29 – *Financial Instruments: Recognition & Measurement*	Editorial amendment that replace the word "Entity Combination" to "Public Sector Combination".	2(f), AG35, AG131 & B4
MPSAS 31 – *Intangible Asset*	Include in the scope and additional requirement of goodwill that result from PSC and IA asset acquired through PSC.	18, 18A, 26A & 39A-39E
MPSAS 33 – *First-time Adoption of Accrual Basis MPSASs*	Additional transition relief for MPSAS 40 and it's related treatment in other MPSASs.	62A, 62B, 62C, 86, 129, 130 & 132
MPSAS 35 – *Consolidated Financial Statements*	▪ Editorial amendment that replace the word "Entity Combination" to "Public Sector Combination". ▪ Harmonize requirement of MPSAS 40 – i.e. removal of Fair Value measurement.	4, 40, 52, 55A, 56, 57 & 63

Consequence Amendments to Other MPSASs (Cont'd)

MPSAS effected	Reason of amendment	Para. effected
MPSAS 36 – *Investment in Associates and Joint Ventures*	Include the application of MPSAS 40 in the equity accounting.	26, 31, 33, 34A & 34B
MPSAS 37 – *Joint Arrangements*	Include the application of MPSAS 40 in joint operations.	24A

Effective Date

The effective date of MPSAS 40 is January 1, 2023.

Effective date of MPSAS 40

This Standard shall be applied prospectively to public sector combinations for which the amalgamation date or acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2023.

Earlier application is encouraged. If an entity applies this Standard before January 1, 2023, it shall disclose that fact.

To learn more about MPSAS 40 and to view the document, please visit:
https://www2.anm.gov.my/akruan/Pages/MPSAS.aspx