Australian Government
Australian Accounting Standards Board

# Staff Paper

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| **Project:** | **IPSASB ED 60 *Public Sector Combinations*** | **Meeting** | AASB June 2016 (M152) |
| **Topic:** | **Consider draft comment letter** | **Agenda Item:** | 5.1 |
| **Contact(s):** | Kala Kandiah<br>kkandiah@aasb.gov.au<br>(03) 9617 7626<br>Shaun Steenkamp<br>ssteenkamp@aasb.gov.au<br>(03) 9617 7640<br>Junyoung Jeong<br>jjeong@aasb.gov.au<br>(03) 9617 7628 | **Project Priority:**<br>**Decision-Making:**<br>**Project Status:** | Medium<br>Medium<br>Form Board views on ED proposals |

## Introduction and objective of the meeting

1 The objective of this paper is to:

(a) seek the Board's view on the draft AASB submission to IPSASB Exposure Draft ED 60 *Public Sector Combinations*; and

(b) agree on the process for finalising the AASB submission.

## Attachments

Agenda Paper 5.2: Feedback summary for PAP meeting

Agenda Paper 5.3: IPSASB ED 60 *Public Sector Combinations*

Agenda Paper 5.4: IPSASB 'At a glance' document – IPSASB ED 60 *Public Sector Combinations*

## Draft AASB submission

2 The staff recommendations are reflected in the draft AASB submission attached as an Appendix to this paper. The draft submission has been prepared to facilitate the Board's discussion on the specific matters for comment in IPSASB ED 60.

**Question 1 to the Board**

Do Board members have any comments or suggestions on the draft submission? Should any additional issues be noted in the submission?

**Next steps**

3 Staff will update the draft submission to reflect Board members comments, if any, following the Board meeting. Given that there is no further Board meeting before the comment deadline, staff recommend the draft comment letter be finalised out-of-session through the Chair.

| **Question 2 to the Board** |
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| Do Board members agree to finalise the submission out-of-session through the Chair? |

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## APPENDIX: DRAFT COMMENT LETTER

This document is a work in progress and has been prepared by AASB staff to facilitate the deliberations of the AASB on IPSASB ED 60 *Public Sector Combinations* for the purpose of forming tentative Board views.



X May 2016

Mr John Stanford
International Public Sector Accounting Standards Board
277 Wellington Street West
Toronto, Ontario, M5V 3H2
Canada

Dear John,

**IPSASB ED 60 *Public Sector Combinations***

The Australian Accounting Standards Board (AASB) welcomes the opportunity to provide comments on IPSASB ED 60 *Public Sector Combinations* ('the ED'). In formulating its comments, the AASB sought and considered the views of Australian constituents through targeted outreach.

The AASB supports the IPSASB's efforts in addressing public sector combinations. However, the AASB has some concerns regarding the classification of some combinations as amalgamations. In particular, the AASB does not agree that public sector combinations with private sector entities should be classified as amalgamations. In the AASB's view, such combinations should always be accounted for as acquisitions.

The AASB also does not agree that the modified pooling of interests method for amalgamations achieves comparability between current period and prior period operating results. In the AASB's view such comparability would be best achieved with an unmodified pooling of interests method. However, the AASB is aware that requiring entities to restate prior periods could be onerous without providing sufficient benefit to users. In that case, the AASB suggests the IPSASB revise the ED not to conclude that the modified pooling of interests method assists in comparability and that the modified pooling of interests method was selected for cost / benefit reasons.

The AASB's responses to the specific matters for comment in IPSASB ED 60 are included in the Appendix to this letter. If you have queries regarding any matters in this submission, please contact me or Shaun Steenkamp (ssteenkamp@aasb.gov.au).

Yours sincerely,

Kris Peach
Chair and CEO

## APPENDIX

### AASB comments on IPSASB ED 60 *Public Sector Combinations*

The specific matters for comment in the ED are addressed in turn below. Unless otherwise stated, constituent feedback supports the AASB views.

**Specific Matter for Comment 1**

Do you agree with the scope of the Exposure Draft? If not, what changes to the scope would you make?

**Note to Board members**

AASB and NZASB staff agree with the scope proposed in the ED. The NZASB are considering some issues regarding the definitions of *equity interests* and *owners*. However, AASB staff do not propose raising the same concerns in favour of focusing the Board's submission on the classification and accounting for combinations.

4 The AASB agrees with the scope proposed in the ED.

**Specific Matter for Comment 2**

Do you agree with the approach to classifying public sector combinations adopted in this Exposure Draft (see paragraphs 7-14 and AG10–AG50)? If not, how would you change the approach to classifying public sector combinations?

**Note to Board members**

Staff outreach to constituents, NZASB staff and staff at the Accounting Standards Board (ASB) of South Africa indicated a clear preference for acquisition accounting where the combination involves a private sector entity. Constituents were also in favour of amalgamation accounting for combinations under common control and combinations where the economic substance was that a new entity was formed.

As noted in paragraph 6 below, feedback from members of the Business Combinations PAP with a public sector interest indicated appetite for an "economic substance" step in the classification approach. This step would be based on the IPSASB's rationale expressed in paragraph AG22 of the ED:

AG22 The economic substance of an amalgamation is that a new entity is formed, irrespective of the legal form of the resulting entity. This applies equally to a combination in which one party to the combination gains control of one or more operations, and in which the presumption that such a combination is an acquisition is rebutted. If the economic substance of a public sector combination is that one of the parties to the combination continues to exist, this provides evidence that the economic substance of the combination is that of an acquisition, and that the presumption should not be rebutted.

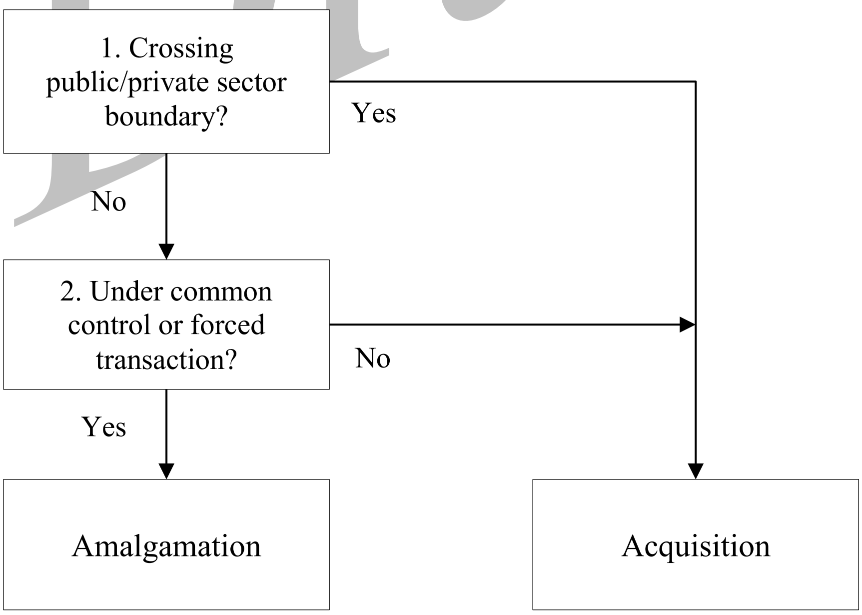
AASB staff think that combinations that are not under common control but are "forced transactions" would be akin to common control transactions as explained below and amalgamation accounting would be appropriate and an economic substance test is not required. Alternatively, if the combination is not a common control transaction or forced transaction, it is most likely that one party to the combination obtains control of the combined operations. Accordingly, AASB staff are of the view that IFRS 3 acquisition accounting would be appropriate in this instance and an "economic substance" test is not required.

5 The AASB disagrees with the proposed approach to classifying public sector combinations.

6 The AASB favours an approach that is more strictly based on the concept of control with some modifications for circumstances unique to the public sector. In this context the AASB has developed a classification approach that could be adopted directly, or be used to develop alternative indicators to the ones proposed in paragraphs 12 and 13 of the ED.



**AASB alternative classification approach**




**Explanation of AASB classification approach**

7 The first step in the approach filters business combinations for those that combine public sector operations with private sector operations. The AASB's view is that such transactions would result in the public sector entity gaining control of the private sector entity's operations in the vast majority of cases. In a combination of operations involving a private sector entity, the AASB concurs with the IASB's rationale in IFRS 3 *Business Combinations* that most business combinations are

acquisitions and 'true mergers' or 'mergers of equals' are so rare as to be virtually non-existent (IFRS 3.BC27 and BC35).

8 The next step would be to consider the combination of operations only in the public sector and whether those combinations are under common control or are a 'forced' transaction (for example a new legislative requirement). In the AASB's view, transactions under common control should be accounted for as amalgamations. The conceptual basis for this treatment is that operations under common control are essentially extracts of a larger operation or entity. Therefore, acquisition accounting would be inappropriate for transactions where the combining operations are merely extracts of a continuing larger operation/entity. The AASB views forced transactions, such as when public sector operations are forced or directed to combine, as akin to a combination under common control. For example, where two local councils are required to combine by legislation passed by the state government even though the state government does not effectively control the councils. Accordingly, those transactions should be accounted for in the same way as combinations under common control i.e. as amalgamations.

9 Constituent feedback indicated an appetite to insert a third step for combinations involving only public sector entities. This step would be to consider the 'substance of the transaction' for combinations not under common control (including 'forced transactions') similar to the IPSASB's rationale in paragraph AG22 of the ED. The aim would be to classify combinations not under common control as amalgamations if the substance of the transaction is that a new entity is formed to assume the operations of the combining entities. If the substance is that one of the parties to the combination continues to exist subsequent to the combination, then this would be treated as an acquisition. The AASB decided not to include this step in the proposed approach above in favour of a simpler classification approach based on common control or akin to common control. The AASB considers that if the proposed approach were to include an economic substance step for combinations not under common control, it could be argued that the accounting for amalgamations would also need to be modified depending on whether the amalgamation is between operations under to common control (i.e. extract of continuing entity) or not (i.e formation of new entity). This would add unnecessary complexity to preparers with little added benefits to users of the financial information.

10 In the AASB's view the alternative classification approach above would work conceptually and is sufficiently simple to apply in practice. However, if the IPSASB decides to continue with its proposed approach in the ED, the AASB suggests some modifications to the indicators in paragraphs 12 and 13 of the ED on when acquisition accounting may be rebutted, to achieve an outcome similar to the above classification approach. The AASB suggests the IPSASB:

(a) remove the indicator in paragraph 12(c) of the ED. This indicator would permit combinations involving private sector NFP entities, like a charity organisation, to be classified as amalgamations. It is the AASB's view that any combination involving a private sector entity should be accounted for as an acquisition.

(b) remove the indicator in paragraph 13(b) of the ED. The AASB does not think that this is a relevant indicator as it is similar to shareholder approval in the private sector where only acquisition accounting is permitted. Higher-level approval should not be a factor in classification.

**Specific Matter for Comment 3**

Do you agree that the modified pooling of interests method of accounting should be used in accounting for amalgamations? If not, what method of accounting should be used?

**Note to Board members**

The 'pooling of interest' method in IAS 22 *Business Combinations* accounts for the combining operations as though they were continuing as before, although now jointly owned and managed. The financial statement items of the combining operations for the period in which the combination occurs, and for any comparative periods disclosed, are included in the financial statements of the resulting entity as if they had been combined from the beginning of the earliest period presented. In other words, the recognition point is the beginning of the earliest period presented, and, consequently, comparative information is restated.

The main difference between the IPSASB's modified pooling of interests method and the pooling of interests method in IAS 22 is that the IAS 22 method requires restated comparative information whereas the modified method does not require comparatives as the date of amalgamation is taken to be the date of combination. The IPSASB's rationale for proposing the modified pooling of interests method is because "it portrays the amalgamation as it actually is. This is because it recognises the assets and liabilities of the combining operations at the date of the amalgamation. Supporters consider this to be a faithful representation of the amalgamation." (BC52).

AASB staff do not necessarily disagree with this rationale, particularly in the case where the combination results in effectively a new entity being formed. However, AASB staff disagree with the IPSASB that the modified pooling of interests method facilitates comparability with prior period operating results (see paragraphs AG43 and AG45). AASB staff think that such comparability could not be achieved without restating comparatives. Accordingly, AASB staff prefer the "pure" pooling of interests method, as described in IAS 22 if the aim of the IPSASB is to achieve this comparability. Also, for combinations of operations under common control, where the combination is merely an extract or continuation of a larger entity, the 'pure' pooling of interest method would be most appropriate. This topic received mixed views from outreach to NZASB and ASB staff, and PAP members. However, most PAP members agreed that for combinations under common control, the pooling of interest method would be most appropriate.

NSW TPP 09-03 provides the accounting requirements for public sector combinations under common control. These requirements are broadly based on AASB 1004 *Contributions*. AASB 1004 does not require the restatement of comparatives, however TPP 09-03 does require comparatives for the transferred function or activity to be included in the notes to the financial statements for accountability and comparability purposes.

AASB staff acknowledge that restating comparatives could be onerous, and therefore can accept the modified pooling of interests method. However, staff would suggest the IPSASB note cost / benefit concerns in the final standard and not conclude that the modified pooling of interests method assists comparability with prior periods.

11 The AASB disagrees that the modified pooling of interests method of accounting should be used in accounting for amalgamations.

12 The AASB considers that the pooling of interests method specified in IAS 22 *Business Combinations* and paragraph BC43 of the ED (which requires restated comparatives), which accounts for the combining operations as though they were continuing as before, although now jointly owned and managed is most appropriate for amalgamations, especially given the ED's aim to achieve comparability between current period and prior period operating results. .

13 However, the AASB acknowledges that the benefits derived from applying the IAS 22 pooling of interests method might not outweigh the costs. Accordingly, the AASB could accept the modified pooling of interests method on a cost / benefit rationale If the IPSASB decides to require the modified pooling of interest method for amalgamations in its final standard, the AASB suggests that the IPSASB include a cost / benefit rationale for the decision in the its basis for conclusions.

14 In addition, the AASB would suggest that the final Standard should not conclude that the modified pooling of interests method assists comparability of current period with prior period results.

**Specific Matter for Comment 4**

Do you agree to adjustments being made to the residual amount rather than other components of net assets/equity, for example the revaluation surplus? If not, where should the adjustments be recognised?

Do you agree that the residual amount arising from an amalgamation should be recognised:

(a) In the case of an amalgamation under common control, as an ownership contribution or ownership distribution; and

(b) In the case of an amalgamation not under common control, directly in net assets/equity?

If not, where should the residual amount be recognised?

15 The AASB suggests that the IPSASB not prescribe where in equity the residual amount is recognised. Instead, this should be left to entities to determine the most appropriate treatment. This view is also consistent with the IASB's tentative views in the Business Combinations under Common Control project.

**Specific Matter for Comment 5**

Do you agree that the acquisition method of accounting (as set out in IFRS 3, *Business Combinations*) should be used in accounting for acquisitions? If not, what method of accounting should be used?

16 The AASB agrees that the acquisition method in IFRS 3 should be used in accounting for acquisitions.