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Ms Stephenie Fox
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CANADA

Dear Stephenie

IPSASB Consultation Paper *Public Sector Combinations*

The Australian Accounting Standards Board (AASB) is pleased to provide comments on the IPSASB Consultation Paper *Public Sector Combinations* (the CP).

Overall, the AASB has strong reservations about the preliminary views. The AASB is concerned with the direction the project has taken since the IPSASB considered comments on IPSASB ED 41 *Entity Combinations from Exchange Transactions*. In particular, the AASB disagrees with the IPSASB not proceeding with adapting IFRS 3 *Business Combinations* (IFRS 3), where appropriate, for the public sector. In that regard, consistent with the approach in IFRS 3, the AASB notes that treating combinations of public sector entities not under common control as acquisitions is likely to address most financial reporting issues that arise in such circumstances.

Further, the AASB notes that the CP includes preliminary views relating to combinations under common control – an aspect of accounting that is yet to be fully addressed by the IASB. The AASB encourages the IPSASB to undertake further research into combinations of public sector entities under common control, particularly if the IASB is not expected to address related private sector issues in a timely manner. However, the AASB encourages the IPSASB to approach the IASB with a view to identifying how the two Boards could work together on the issues – but the IPSASB should not delay its work if the IASB is not yet ready to proceed. Further, to help keep the project focussed, the IPSASB should not address the accounting by transferors and, if the IPSASB finds that pursuing common control issues slows down its consideration of non-common control issues, the IPSASB should consider dividing the project into two separate projects.

In addition to the general comments above, the AASB also has a number of concerns and comments on specific aspects of the preliminary views, as outlined in the attachment.

If you have any queries regarding any matters in this submission, please contact Nikole Gyles (ngyles@aasb.gov.au).

Yours sincerely

Kevin M. Stevenson
Chairman and CEO

AASB's Specific Comments on the IPSASB Consultation Paper
Public Sector Combinations

The AASB's views on the questions in the CP are as follows:

Specific Matter for Comment 1 (following paragraph 2.49)

In your view, is the scope of this CP appropriate?

The AASB agrees with the scope of the CP in the context of the approach taken in the CP (i.e. to consider more broadly the approaches to accounting that might be adopted for public sector combinations (PSCs) arising in different circumstances) except for the proposed inclusion of transferor accounting. The AASB thinks that excluding transferor accounting from the scope of the CP would help ensure the project remains focussed on the key issues relating to public sector combinations. Further the AASB considers that the accounting requirements for a transferor are already addressed by other IPSASs.

Specific Matter for Comment 2 (following paragraph 2.49)

In your view, is the approach used in this CP of distinguishing between acquisitions and amalgamations, with a further distinction for PSCs NUCC and UCC, appropriate? If you do not support this approach, what alternatives should be considered? Please explain your reasoning.

The AASB thinks that, in practice, the distinction between an acquisition and amalgamation is likely to be difficult in some circumstances (whether in the private or public sectors). The AASB is not persuaded by the arguments presented in the CP for drawing the distinction between acquisitions and amalgamations, as noted in the response to Specific Matter for Comment 3, below.

The AASB thinks that treating PSCs not under common control (NUCC) as acquisitions is likely to address most financial reporting issues that arise in such circumstances.

As noted in the covering letter to this submission, the AASB encourages the IPSASB to undertake further research into PSCs under common control (UCC), particularly if the IASB is not expected to address related private sector issues in a timely manner.

Specific Matter for Comment 3 (following paragraph 3.13)

In your view, are there other public sector characteristics that should be considered in determining whether one party has gained control of one or more operations?

As noted in response to specific matter for comment 2 above, the AASB disagrees with the distinction between acquisitions and amalgamations, particularly in a NUCC context. The AASB considers that the CP does not provide a sufficient conceptual basis, or specific public sector reasons, as to why public sector entities should be required to distinguish acquisitions from amalgamations. In addition, such a distinction may also be considered to be a backwards step from the requirements of IFRS 3, which removed the concept of mergers[1] on the basis that 'true mergers' in which none of the combining entities obtains control of the others are so rare as to be virtually non-existent. Further, in developing IFRS 3, a non-arbitrary boundary for distinguishing true mergers or mergers of equals from other business combinations was not able to be established (IFRS 3, para. BC35).

In addition, the AASB considers the implication in the CP that no goodwill typically arises ignores the fact that many public sector combinations result in the deferral of cash outflows. It is inappropriate to imply that no asset is created when two entities are combined, because it raises the question of why the two entities would have been combined in the first place.

The AASB acknowledges that entity combinations UCC circumstances might fundamentally differ from entity combinations NUCC circumstances and therefore might justify a different conclusion about acquisition or amalgamations and therefore a different accounting treatment. Therefore, before arriving at any conclusion, the AASB thinks the issues need to be comprehensively considered in both a for-profit and not-for-profit context. As noted in the cover letter to this submission, the AASB encourages the IPSASB to undertake further research into PSCs UCC, particularly if the IASB is not expected to address related private sector issues in a timely manner.

Specific Matter for Comment 4 (following paragraph 5.25)

In your view, should the recipient in an acquisition NUCC recognize in its financial statements, the acquired operation's assets and liabilities by:

(a) Applying fair value measurement to the identifiable assets acquired and liabilities assumed in the operation at the date of acquisition for all acquisitions (Approach A);

(b) Distinguishing between different types of acquisitions (Approach B) so that:

(i) For acquisitions where no or nominal consideration is transferred, the carrying amounts of the assets and liabilities in the acquired operation's financial statements are recognized, with amounts adjusted to align the operation's accounting policies to those of the recipient, at the date of acquisition; and

(ii) For acquisitions where consideration is transferred, fair value measurement is applied to the identifiable assets acquired and liabilities assumed in the operation, at the date of acquisition; or

(c) Another approach?

Please explain why you support Approach A, Approach B or another approach.

The AASB agrees with the reasons provided in the CP paragraphs 5.9-5.14 supporting the adoption of fair value as the measurement basis for all acquisitions (Approach A). This basis is also consistent with the basis used in IPSASs when acquiring assets or incurring

[1] Although the AASB acknowledges that IFRS 3 is soon to be subject to a post-implementation review, it is too early to pre-empt any outcomes of that review with regard to any proposed changes to IFRS 3, including any reinstatement of the merger concept.

liabilities individually, including ‘non-exchange’ transactions.

The AASB is not convinced by the arguments supporting Approach B. The AASB thinks it would be inappropriate to regard consideration as a determining factor when measuring identifiable assets acquired and liabilities assumed. Further, the AASB is concerned that requiring different accounting treatments in circumstances where consideration is transferred (above a nominal amount) and circumstances where consideration is not transferred may lead to structuring opportunities. This may particularly be the case for combinations UCC.

Specific Matter for Comment 5 (following paragraph 5.46)

In your view, where the consideration transferred is in excess of the net assets acquired, should the difference arising in an acquisition NUCC (for both Approach A and Approach B, acquisitions where consideration is transferred) be recognized in the recipient’s financial statements, on the date of acquisition, as:

(a) Goodwill for acquisitions where the acquired operation is cash-generating and a loss for all other acquisitions;

(b) Goodwill for all acquisitions (which would require development of a definition of goodwill that encompasses the notion of service potential); or

(c) A loss for all acquisitions?

Please explain why you support (a), (b), or (c).

In Australia, the requirements of Australian Accounting Standard AASB 3 *Business Combinations* (which incorporates the requirements of IFRS 3) in relation to goodwill apply to both for-profit and not-for-profit entities.[2] The AASB is not aware of any resulting significant implementation issues specific to public sector entities. Based on the experience in Australia, the AASB supports option (b), the recognition of goodwill for all acquisitions. The AASB does not support the view that goodwill can only be associated with for-profit entities.

In addition, the AASB considers that the CP should acknowledge that combinations might involve a non-exchange component. Consequently, the AASB thinks the IPSASB should consider the relationship between the IPSASB’s work on this project and IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

Specific Matter for Comment 6 (following paragraph 6.26)

In your view, should the recipient in an acquisition UCC recognize in its financial statements, on the date of acquisition, the difference arising as:

(a) A gain or loss recognized in surplus or deficit (in the statement of financial performance);

[2] The only exception to the general requirements of AASB 3 relate to restructures of local governments in paragraphs Aus63.1-Aus63.9.

(b) A contribution from owners or distribution to owners recognized directly in net assets/equity (in the statement of financial position); or

(c) A gain or loss recognized directly in net assets/equity (in the statement of financial position), except where the transferor is the ultimate controlling entity and then the gain or loss meets the definition of a contribution from owners or distribution to owners?

Please explain why you support (a), (b), or (c).

In Australia, Australian Accounting Standard AASB 1004 *Contributions* specifies requirements for the accounting for the restructure of administrative arrangements (i.e. PSCs UCC), including a requirement that a contribution from owners or distribution to owners is recognised in relation to assets and liabilities transferred (paras. 54-59)[3]. The AASB is not aware of any significant implementation issues specific to public sector entities arising from these requirements.

Accordingly, the AASB supports option (b), that a contribution from owners or distribution to owners be recognised directly in net assets/equity (in the statement of financial position).

In addition to supporting option (b), the AASB thinks that the IPSASB should consider the implications of the fact that the definition of equity in IPSASs is restricted, compared with IFRSs, due to the IPSASB's equity definition referencing instruments.

Further, the AASB notes that issues pertinent to this specific matter for comment raise fundamental questions about the nature of entities within government. In particular, whether entities within government should be regarded as separate/stand-alone entities or segments/disaggregated parts of the government. Addressing such issues could slow down the whole project and therefore the IPSASB should consider dividing the project into two separate parts so as not to delay its work on PSCs NUCC.

Specific Matter for Comment 7 (following paragraph 6.31)

In your view, should the accounting treatment for the recipient and transferor of an acquisition UCC be symmetrical?

In general terms, the AASB agrees that logically the contribution/distribution or gain/loss recognised by the recipient and transferor of an acquisition UCC should be symmetrical. However, due to the nature of the assets being transferred, and the requirement for different measurement bases across Standards, the AASB acknowledges that in some circumstances the accounting outcome may not be symmetrical.

In relation to the question of symmetry, the AASB particularly considers that thought should be given to complex groups where there may be a chain of entities and how entities that fall between an ultimate parent and a transferee or transferor may be affected.

[3] These paragraphs reflect relatively recent thinking of the AASB and are not expected to be amended as a result of the AASB's *Income from Transactions of Not-For-Profit Entities* project. AASB 1004 paragraphs BC24-BC29 provide the AASB's rationale for the approach adopted in AASB 1004 (Link to AASB 1004 – http://www.aasb.gov.au/admin/file/content105/c9/AASB1004_12-07.pdf – accessed 30 October 2012).