Financial Reporting Council

Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto, Ontario M5V 3H2
CANADA

20 December 2012

Dear Stephenie

Re: Consultation Paper *Public Sector Combinations*

1. The Committee on Accounting for Public Benefit Entities (CAPE) welcomes the opportunity to comment on the above Consultation Paper.

Acquisitions

2. In our view, for public sector combinations that are acquisitions, recording assets and liabilities acquired at fair value provides more relevant information. Therefore, we consider that fair value should be used for all combinations not under common control.
3. Whilst we consider that fair value should be the first high-level principle, we agree that for some acquisitions under common control, there may be less benefit from using fair value and given the costs of using it, it would be appropriate to permit or require the use of previous carrying amounts.
4. For acquisitions under common control we do not agree that the criterion for the use of fair value or carrying amount should be whether no or nominal consideration is provided. In our view, a superior test is to make a determination of the substance behind the combination. If the transaction is in substance a commercial transaction or is at arm's length, then fair value is appropriate. However, in other cases where there is no commercial substance to the transaction for example, if it is an involuntary combination as a result of a policy directive or regulation, then the carrying amount may be appropriate.
5. For all transactions, where fair value is used, any excess of the consideration over the fair value of the net assets acquired should be treated as goodwill. We agree that it is debateable whether goodwill meets the definition of an asset: however, treating it as such is necessary in order to meet the accountability objective of financial reporting.

6. We also agree that if the fair value of the net assets acquired is greater than the consideration paid (i.e. negative goodwill) then the difference should be treated as a gain.

7. For acquisitions under common control that are recorded at previous carrying amounts, our view is that any difference between the consideration given and the amount of the acquired assets and liabilities meets the definition of a contribution to or distribution from owners and should be treated as such.

Amalgamations

8. We agree that amalgamations should be accounted for by the modified pooling of interest method. We support the modifications proposed to 'traditional' pooling of interest accounting, which we consider appropriate. We note that the modified pooling of interest method is similar to fresh start accounting, except that assets and liabilities are stated at previous carrying amounts rather than at fair value. That said, we consider that fair value should be permitted as an alternative, where it is judged that its advantages—in particular the superior relevance of current values—outweigh the costs of doing so.

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9. We have not commented above on the conceptual basis of fair value, as we agree that this should be considered separately as part of IPSASB's project on its Conceptual Framework. However, we urge IPSASB to consider whether a standard on Public Sector Combinations should be finalised before IPSASB has concluded its work on the Framework.

10. Our comments to the Specific Matters for Comment are set out in the attached Appendix. If you require any further information please contact Joanna Spencer (j.spencer@frc.org.uk) or telephone +44 (0) 7492 2428.

Yours sincerely

M McLaren

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Specific Matters for Comment

Specific Matter Comment 1 (paragraph 2.49)

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

Yes.

Specific Matter for Comment 2 (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 alternative should be considered? Please explain your reasoning.

We concur with the distinction between acquisitions and amalgamations. However, as noted in the covering letter and in our response to SMC 4, in our view the accounting for NUCCs and some UCCs should be the same.

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?

We are unaware of any further relevant public sector characteristics.

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.

As explained in the covering letter, we support Approach A.

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).

As explained in the covering letter, we consider that for acquisitions NUCC where the consideration given is greater than the net assets recognised, goodwill should be recognised for all transactions (b) however, we do not consider that this requires the development of a new definition of goodwill.

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);

(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).

As explained in the covering letter, we consider that the difference arising should be treated as a contribution from, or distribution to, owners (b). We do not accept that this be restricted to cases where the transferor is the ultimate controlling entity.

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 our view the accounting should be symmetrical.