AUSTRALASIAN
COUNCIL OF
AUDITORS-GENERAL

31 October 2012

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

Dear Ms Fox

Consultation Paper
Public Sector Combinations

Attached is the Australasian Council of Auditors-General (ACAG) response to the Consultation Paper referred to above.

The views expressed in this submission represent those of all Australian members of ACAG.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely

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Chairman
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Consultation Paper
Public Sector Combinations

ACAG provides the following comments in response to the IPSASB's request for comments on the Preliminary Views and feedback on the specific matters in the Consultation Paper (CP).

Overall Comments

ACAG supports the development of a single standard identifying the accounting requirements for Public Sector Combinations (PSCs). In this regard, ACAG supports the development of an accounting standard which is consistent with existing requirements of IFRS 3 *Business Combinations,* modified where appropriate, to reflect public sector considerations.

While ACAG supports the development of an accounting standard, ACAG does not support the proposed approach of distinguishing between "amalgamations" and "acquisitions" in relation to PSCs Under Common Control (UCC). The distinction between "acquisitions" and "amalgamations" for PSCs Not Under Common Control (NUCC) is supported.

Detailed comments are provided below in relation to the Specific Matters for Comment. Additional comments are provided in relation to a number of matters for which ACAG believes further consideration should be given in developing a future accounting standard.

These comments have been provided based on ACAG's experience in accounting for PSCs in Australia.

Specific Matter for Comment 1

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

ACAG believes the scope of the CP is generally appropriate as it deals with PSCs that involve:

- entities UCC and NUCC
- consideration and no or nominal consideration
- transfers of net assets and net liabilities.

ACAG also supports the exclusion of transfers of assets and liabilities that do not represent "operations". However, ACAG believes further guidance is required in relation to the definition of "operations". While the definition of "operations" is broader than that of "business" included in IFRS 3, we believe that this may still be open to interpretation. Our experience in dealing with business combinations under IFRS 3/AASB 3 is that where differences of opinion exist in relation to the meaning of "business", they can be difficult and costly to resolve.

Where other IPSASB standards already identify accounting treatments for transfers outside the proposed scope of this CP, references to the relevant standards would be useful to provide additional guidance for these areas.

ACAG believes that in developing a future accounting standard, consideration should also be given to providing guidance/clarification in relation to the following areas:

- whether the requirements for PSCs NUCC also apply to situations where one or more of the parties is not a public sector entity, or only where all parties to the PSC are public sector entities
- accounting for transfers by transferors for PSCs UCC, particularly where symmetrical accounting treatment is required between recipients and transferors (an example of why this may be relevant has been included in relation to Specific Matter for Comment 7)
- if a substantive difference in accounting treatment is retained in the proposed standard based on whether consideration (other than nominal consideration) is transferred, the definition of "nominal consideration" and whether this includes an amount that does not represent a reasonable approximation of the fair value of the operations transferred
- accounting for adjustments on the transfer of operations that arise from the application of different fair value estimation techniques e.g. going from an income based approach to depreciated replacement cost
- development of additional disclosure requirements to explain why the going concern basis is considered appropriate where a PSC UCC results in a public sector entity ceasing to be a going concern as proposed in Preliminary View 9.

Specific Matter for Comment 2

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.

ACAG supports the distinction between PSCs UCC and NUCC. However, ACAG does not support a distinction between "amalgamations" and "acquisitions" in relation to PSCs UCC.

In particular, this distinction appears to be based more on the form or outcome of the PSC rather than the substance. In Australia, PSCs UCC most commonly arise as an involuntary transfer of operations at the direction of the controlling entity. In these circumstances, ACAG believes the accounting treatment should be the same regardless of whether the PSC is an "acquisition" or an "amalgamation".

In our view, a more appropriate approach would be for the accounting treatment to be based on whether the PSC UCC is voluntary or involuntary in nature. Further explanation of how this would be applied is provided in relation to Specific Matter for Comment 6.

The distinction between "acquisitions" and "amalgamations" for PSCs NUCC is supported. ACAG believes that an indicator for an amalgamation NUCC (as discussed in the CP at paragraph 3.12) is the fact that the combination is involuntary i.e. imposed by virtue of legislation, ministerial direction or other externally imposed requirement.

Specific Matter for Comment 3

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?

In Australia, AASB 127 *Consolidated and Separate Financial Statements* identifies a number of factors that may indicate the existence of control in a public sector environment, including:

- the entity is accountable to Parliament, or the Executive or a particular Minister as evidenced by:
    - the existence of a Ministerial or other government power enabling the government to direct the entity's governing body to achieve the government's policy objectives;
    - Ministerial approval is required for operating budgets;
    - the government has the ability to veto operating and capital budgets of the entity;
    - the government has broad discretion, under existing legislation, to appoint or remove a majority of the members of the governing body of the entity;
    - the entity is required to submit to Parliament reports on operations, including audited financial statements under legislative requirements applying generally to public sector entities or the entity's own enabling legislation; or
    - the mandate of the entity being established or limited by its enabling legislation.
- the government has a residual financial interest in the net assets of the entity arising from:
    - the government being exposed to residual liabilities of the entity; or
    - the government having the right to receive the residual net assets of the entity if that entity is dissolved.

Specific Matter for Comment 4

In your view, should the recipient in an acquisition NUCC recognise 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 recognised, 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.

ACAG supports the use of Approach A. Under Australian Accounting Standard AASB 3 *Business Combinations*, an acquisition NUCC would normally be accounted for by applying fair value measurement to the assets acquired and liabilities assumed. However, AASB 3 provides an exemption where there is a transfer of assets between local governments. In these circumstances, AASB 3 (Aus63.2) provides:

> ***Assets transferred to a local government from another local government at no cost, or for nominal consideration, by virtue of legislation, ministerial directive or other externally imposed requirement shall be recognised initially either at the amounts at which the assets were recognised by the transferor local government as at the date of the transfer, or at their fair values.***

In Australia, local governments are considered to be NUCC. Generally, transfers between local governments are recorded at the carrying amounts recognised by the transferor local government.

Specific Matter for Comment 5

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 recognised 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).

ACAG supports option (a) on the basis that the recognition of goodwill in public sector entities would have limited impact for the entities within the scope of the CP since, in Australia, the objective of public sector entities is generally to deliver goods and/or services rather than the generation of cash returns, particularly as the accounting treatment of a combination in the financial statements of Government Business Enterprises is excluded from the scope of this CP.

Specific Matter for Comment 6

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

(a) A gain or loss recognised in surplus or deficit (in the statement of financial performance);
(b) A contribution from owners or distribution to owners recognised directly in net assets/ equity (in the statement of financial position); or
(c) A gain or loss recognised 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?

ACAG agrees with Preliminary View 7 in the CP that the recipient in an acquisition UCC recognises in its financial statements, on the date of acquisition, the carrying amounts of the assets and liabilities in the acquired operation's financial statements with amounts adjusted to align the operation's accounting policies to those of the recipient.

ACAG believes that whether the difference in a PSC UCC is recognised as a contribution from owners/distribution to owners should depend on the substance rather than the form or outcome of the PSC. In this regard, ACAG support the PSC being recognised as a contribution from owners/distribution to owners directly in net assets/equity where:

1. it involves an involuntary transfer of an operation at the direction of the controlling entity or by virtue of legislation or ministerial directive; and/or
2. the controlling entity designates the PSC to be a contribution by/distribution to owners.

ACAG believes this is more reflective of a transaction by owners acting in their capacity as owners. This approach is also more consistent with the basis of accounting adopted in Australia under AASB 1004 *Contributions* and AASB Interpretation 1038 *Contributions by Owners Made to Wholly-Owned Public Sector Entities*.

Where the transfer is voluntary in nature, and is not designated to be a contribution by/distribution to owners, the difference should be treated as a gain or loss in the statement of financial performance. This is because such PSCs do not represent transactions with owners in their capacity as owners.

Specific Matter for Comment 7

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

ACAG supports the symmetrical treatment of acquisitions UCC in the accounts of the recipient and transferor. However, ACAG recommends that any accounting standard developed should include additional guidance on how this symmetry can be achieved where the transfers are to be accounted for as a contribution from/distribution to owners and adjusted directly through equity.

Specific guidance should be provided as to how distributions to owners are to be accounted for where the value of the net assets transferred is greater than the Contributed Equity of the transferor. In particular, can the difference be adjusted by the transferor against another equity account such as accumulated surpluses, or should the difference be accounted for as a loss by the transferor and a gain by the recipient? Similar issues may arise where a recipient entity assumes net liabilities under a PSC UCC.

This is an area where the current accounting requirements in Australia are silent. Some jurisdictions within Australia have developed their own requirements for accounting for the equity adjustments, resulting in different accounting treatments between jurisdictions.

Another issue to be considered relates to the treatment of asset revaluation surpluses on the transfer of the related assets. In particular, can a recipient entity recognise the asset revaluation surpluses relating to the transferred assets where either an operation is transferred to a single entity or a new entity is created? At present, it would appear that such a transfer is not allowed under existing accounting standards in Australia. As such, examples have been identified in the restructures of administrative arrangements where property, plant and equipment is transferred from one government department to another under the restructure. In these circumstances, the asset revaluation surplus cannot be transferred to the new department. However, at the Whole-of-Government level the asset revaluation surplus remains as there has been no change to the position of the economic entity.

The above points can be demonstrated through the following example:

Entity A is required to transfer an operation with assets of $700,000 and liabilities of $300,000 to Entity B as part of a PSC UCC. At the time of the PSC, Entity A's Statement of Financial Position identifies the following:

	Entity A	Operation
Total Assets	$1,000,000	$700,000
Total Liabilities	$500,000	$300,000
Net Assets	**$500,000**	**$400,000**
Contributed Equity	$100,000	$100,000
Accumulated Surplus	$200,000	
Asset Revaluation Surplus	$200,000	$200,000
Total Equity	**$500,000**	

Assuming the transfer meets the definition of a distribution to owners, how is this accounted for against equity in the accounts of Entity A? In particular:

- is the distribution to owners limited to the $100,000 in Contributed Equity and $200,000 in Accumulated Surplus? If so, what happens to the remaining $100,000? IPSASB guidance is required as to which equity line items constitute equity that is available to be transferred in a distribution from owners.
- can the distribution be used to turn the Accumulated Surplus into a deficit without going through the Statement of Comprehensive Income? Is this consistent with a distribution to owners which should, in theory, be limited to a return of equity and a distribution of profits?
- Although we acknowledge the guidance in IPSAS 17 *Property, Plant and Equipment* paragraph 57, how should the Asset Revaluation Surplus be treated if the asset classes to which they relate are (i) transferred, (ii) not transferred? Without the transfer of the Revaluation Surplus to Entity B, Entity B may be required to record any future revaluation decrements through surplus/deficit even though, from the perspective of the economic entity, these could be offset against the Asset Revaluation Surplus.
- Can the distribution to owners be shown as a separate debit balance of $400,000 in equity?
- To what extent would the accounting be "symmetrical" in the accounts of Entity B?