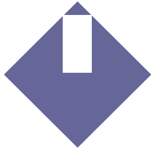

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October 30, 2012

Ms. Stephenie Fox
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International Federation of Accountants
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Comments on the Consultation Paper "Public Sector Combinations"

Dear Ms. Fox,

The Japanese Institute of Certified Public Accountants (JICPA) is pleased to comment on the Consultation Paper (CP) "Public Sector Combinations," as follows.

Comments on Specific Matters

Specific Matter for Comment 1: In your view, is the scope of this CP appropriate?

We believe that the scope of the CP is appropriate, since acquisition of assets, assumption of liabilities and interests in joint ventures should be prescribed separately.

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.

We agree with the CP's approach that distinguishes between acquisitions and amalgamations, with a further distinction for PSCs NUCC and UCC.

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?

We are not aware of any characteristics, other than those described in the CP, that should be considered in determining whether one party has gained control of one or more operations.

Specific Matter for Comment 4:

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 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.

Our Committee carefully considered these approaches; however, we have divided opinions. Some of the members support Approach A, while other members supported Approach B.

Paragraphs 5.19 to 5.23 only explain, as advantages of Approach B, the usefulness of using carrying amounts, except for the convenience of the operations. Those who support Approach A believe that these reasons cannot justify the special approach for the public sector. Therefore, they suggest that, in public sector acquisitions, all of the acquired operation's assets and liabilities should be measured at fair value, in the same manner as in the IFRS.

On the other hand, those who support Approach B believe that acquisitions in the public sector are usually based on the continuity of operations. If the measurement basis of acquired assets and liabilities would change, users could not assess the entities' financial performance on the basis of the continuity.

Related to this question, we recognize the following additional issues:

(a) Approach B (i) states "with amounts adjusted to align the operation's accounting policies to those of the recipient." However, there would not be so many cases of different accounting policies, since IPSASs rarely permit alternative accounting treatments.

(b) Paragraph 5.18 states "the recipient should recognize and measure the net assets acquired on the date of acquisition at the carrying amount in the acquired operation's financial statements, with amounts adjusted to align the operation's accounting policies to those of the recipient." We are concerned that this provision could pose a problem when the transferor adopts the revaluation model for the measurement after recognition of fixed assets, and the recipient adopts the cost model. When they comply with the provision, the fixed assets revaluated by the transferor should be restated to cost, in order to "align the operation's accounting policies to those of the recipient." This adjustment may be difficult to implement, since some entities do not record their historical costs under the revaluation model.

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 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).

We support (a) goodwill for acquisitions of cash-generating operations and loss for all other acquisitions.

When the acquired operation is cash-generating, it will provide future economic benefits that meet the definition of an asset. In this case, goodwill can be recognized as an asset. We believe all other acquisitions should be recognized as a loss (or directly recognized in net assets discussed in the following paragraph) where the consideration transferred is in excess of the net assets acquired. It is because we agree with the viewpoint of paragraph 5.41 "service potential that is not capable of being individually identified and separately recognized does not arise" (this is consistent with the view of IPSAS 26).

Also, we suggest that IPSASB should consider another option: the difference is directly recognized as net assets in the recipient's statement of financial position. Public sector entities may acquire operations for the purpose of continuing to provide their service for the residents, rather than for the purpose of making a profit. In this case, we believe that it is appropriate to regard a receipt of "impaired net assets," rather than as a loss of the recipient (performance of the recipient).

Related to this question, we recognize the following additional issues:

(a) With respect to “where the acquired operation is cash-generating” described in the option (a), Paragraph BC 15 of the IPSAS 21 states to the effect that individual assets (not group of assets) are determined whether cash-generating or non-cash-generating. Paragraph BC 14 of the IPSAS 21 also defines that cash-generating assets are determined by whether its “primary objective is generating a commercial return.” We suggest IPSASB should clarify the relationship between (a) “where the acquired operation is cash-generating”; and (b) where “primary objective is generating a commercial return”

(b) We do not agree for IPSASB to develop a definition of goodwill that encompasses the notion of service potential.

(c) It should be considered that, when the primary objective of the acquired operation is not cash-generating, the difference as a result of the acquisition may be recognized as deferred outflow.

> Specific Matter for Comment 6:
> 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).

We support (a) A gain or loss recognized in surplus or deficit on the basis that the accounting treatment of an acquisition UCC between the recipient and the transferor should be symmetrical (please see our comments to the Specific Matter for Comment 7 below), and the transferor should recognize the difference between the proceeds from disposal and the controlled entity’s amount as a gain or loss on disposal of a controlled entity (prescribed in the paragraph 51 of IPSAS 6).

Specific Matter for Comment 7:

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

We believe that the accounting treatment for the recipient and transferor of an acquisition UCC should be symmetrical, since the acquisition is merely an internal transfer for the ultimate controlling entity. We suggest that the resulting entity should succeed the combining entity's structure of net assets (each amount of line items) under the amalgamation UCC.

Other Comments

If IPSASB's conceptual framework will prescribe deferred inflow and deferred outflow, another issue may arise on Specific Matter for Comment 4. When the acquired operation NUCC contains deferred items, there would be 3 options: (a) to use the carrying amounts; (b) to eliminate it; or (c) to measure it on fair value basis.

We would not choose option (c), since the deferred items are the inflow (or outflow) of resources in the past which are expected to be taken to income or expense in a specified future period. It depends on the definition and criteria of deferred items. However, as long as it has the specified future period for the use of resource flow, option (a) would be appropriate.

Also, when the pooling of interests method is applied to an amalgamation, accounting policies of combining operations have to be aligned to those of resulting entity. The adjustment of assets and liabilities should be directly accounted for in accumulated surpluses or deficits on the amalgamation date (or at the beginning of the first period presented) in accordance with Paragraphs 27 of IPSAS 3, Retrospective Application.

Yours sincerely,

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