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

Dear Sirs,

Consultation Paper on Public Sector Combinations (PSC)

The Accounting and Auditing Standards Desk of the Abu Dhabi Accountability Authority (ADAA) is pleased to provide a response to the International Public Sector Accounting Standards Board (IPSASB) request for comments on its Consultation Paper regarding Public Sector Combinations (CP). We are wholly supportive of the IPSASB's objectives to enhance the quality and consistency of financial reporting of Public Sector Entities (PSEs) and to improve the transparency and accountability of government reporting.

Public sector combinations are a significant and necessary feature of government activities, undertaken to reshape and refocus government operations in order to facilitate achievement of government strategies. The absence of accounting guidance in this area doubtless has contributed to diversity in practice and we welcome this opportunity to respond to the CP.

Our experience is focused on PSEs under common control (UCC). PSEs UCC do not normally set out to acquire other PSEs (or parts thereof). When a PSE does acquire another PSE (or part thereof) it is unusual in our experience for cash consideration or some other form of purchase price consideration to be exchanged. It is usual for any government debt (or deferred income) that is linked to the operation being acquired to be passed from the transferor to the acquirer of the operation.

Our primary use of general purpose financial statements is comparability of PSEs UCC to ensure accountability and stewardship of operations and assets. Comparability includes comparability of current and predecessor PSEs and of performance in current and past reporting periods, therefore our preferred accounting base for acquisitions by PSEs UCC is historic cost. PSCs not under common control (NUCC) are unusual in our territory however in such situations we consider fair value accounting is the preferred accounting base either because it is likely some form of purchase price consideration is required in order to equalize the value of the assets and liabilities exchanged, or because the transferor or acquirer is providing or receiving either an increase in economic benefits or an increase in service potential.

Preliminary View 1

A public sector combination is the bringing together of separate operations into one entity, either as an acquisition or an amalgamation.

The key definitions are as follows:

(a) An ***acquisition*** *is a transaction or other event that results in a recipient gaining control of one or more operations.*

(b) An ***amalgamation*** *is a transaction or other event where (a) two or more operations combine, (b) none of the combining operations gain control of the other operations, and (c) the transaction or other event is not the formation of a joint venture.*

(c) A ***combining operation*** *is an operation that combines with one or more other operations to form the resulting entity.*

(d) An ***operation*** *is an integrated set of activities and related assets and/or liabilities that is capable of being conducted and managed for the purpose of achieving an entity's objectives, by providing goods and/or services.*

(e) A ***recipient*** *is the entity that gains control of one or more operations in an acquisition.*

(f) A ***resulting entity*** *is the entity that is the result of two or more operations combining where none of the combining operations gains control of the other operations.*

*(g) A **transferor** is the entity that loses control of one or more of its operations to another entity (the recipient) in an acquisition.*

We agree that the seven terms defined above are appropriate. In our experience general purpose financial statements are not prepared for the amalgamation, they are prepared separately for the two or more operations that form the amalgamation for financial reporting purposes of the entities that control the operations contained in the amalgamation.

Preliminary View 2
*A **public sector combination under common control** is a public sector combination in which all of the entities or operations involved are ultimately controlled by the same entity both before and after the public sector combination.*

We agree with the definition of a public sector combination under common control (PSC UCC).

Preliminary View 3
The sole definitive criterion for distinguishing an amalgamation from an acquisition is that, in an amalgamation, none of the combining operations gains control of the other operations.

We agree that the sole criterion for distinguishing an amalgamation from an acquisition should be control.

Preliminary View 4
An acquisition NUCC should be recognized in the financial statements of the recipient on the date the recipient gains control of the acquired operation.

We agree that the recognition criteria should focus on the date the recipient gains control.

Preliminary View 5
The recipient in an acquisition NUCC recognizes in its financial statements on the date of acquisition, the difference arising as:
(a) A gain where the recipient acquires net assets in excess of consideration transferred (if any); and
(b) A loss where the recipient assumes net liabilities.

We agree that a PSC NUCC should apply fair value measurement criteria to the assets and liabilities acquired and that any gain or loss arising is recognised in the income statement.

Preliminary View 6
An acquisition UCC should be recognized in the financial statements of the recipient on the date the recipient gains control of the acquired operation.

We agree that the recognition criteria should focus on the date the recipient gains control.

Preliminary View 7
The recipient in an acquisition UCC recognizes 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.

We agree that the recipient in an acquisition UCC recognizes 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. We agree any gain or loss arising from those adjustments is recognised in the income statement.

Preliminary View 8
A resulting entity in an amalgamation should apply the modified pooling of interests method of accounting.

In our experience an entity does not normally prepare general purpose financial statements for an amalgamation. However, if financial statements are to be prepared then we favour the modified pooling of interests method of accounting. We consider that this method is more supportive than other methods because performance and accountability can still be assessed without the complexity of re-measuring assets and liabilities. We note that IPSAS 16 and 17 contain a subsequent measurement revaluation alternative which overcomes any disadvantages of this method.

Preliminary View 9
Where combining operations continue to prepare and present GPFSs using accrual-based IPSASs in the period between the announcement of the amalgamation and the date of the amalgamation, these GPFSs are prepared on a going concern basis where the resulting entity will fulfill the responsibilities of the combining operations.

We agree with preliminary view 9. In our experience the key point to assess is whether government will continue to provide support to the operations delivering the goods or services and not whether the legal entity itself is going to continue those operations. Management preparing the financial statements and the auditor providing an opinion on the financial statements are required by other accounting and auditing standards to reflect appropriate disclosure of the effect on the going concern basis in the financial statements.

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

We agree the scope of the CP is appropriate.

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 approach used in the CP. It is not uncommon for governments in searching for cost reductions and improvements in service delivery to reorganize public sector operations and move an operation from one reporting entity to another reporting entity with there being no change in the government's ultimate control of those operations. Accordingly, in assessing the quality of management's stewardship of a PSE's assets and delivery of past and future performance, a user of GPFS needs to distinguish between acquisition transactions (UCC and NCC) where consideration is provided and government reorganisation transactions (UCC) where no consideration is provided. Acquisition transactions NUCC necessarily require remeasurement of assets and liabilities to fair value in order to assist such an assessment. Whereas applying fair value remeasurement to government reorganization transactions (UCC) in which there is no change in government control distorts such an assessment.

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 our experience public sector operations do not normally acquire or combine with other public sector operations unless they are instructed to do so by government. For example a newly elected government may overturn decisions taken by a previous government and decide to vertically or horizontally integrate activities that were previously not aggregated, or government may decide to disaggregate operations that were previously aggregated. In such situations it may be clear that the rationale is due to one operation performing at a higher level than the other operation and therefore although it appears that it is the higher performing operation's management that is taking control of the less well performing operation, they are only doing so at the behest of government. Our experience of government decrees, the government budget approval process and government allocation of budget are also characteristics we consider in determining control.

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 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.

We agree with approach A. This approach for acquisitions NUCC is consistent with IFRSs. We consider it unusual that no consideration is transferred in such situations, because if it is not then either the acquirer or the transferor has benefitted economically from the transaction, which in the interests of accountability and stewardship of public assets, should be unlikely. Such a situation could arise where governments are providing benefits across borders to other governments. In such a situation then the value of the operation which has been transferred would be of significance to the public, government and other users of the GPFSs.

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).

In principle we consider goodwill is as likely to arise in public sector acquisitions as it is likely to arise in private sector acquisitions however accounting for goodwill (as evidenced by the changes in the accounting standards) continues to be problematic. Problems arise in the valuation of goodwill, its life, the identification of cash generating units in the operation, the groups of assets and the synergies to which the goodwill is attributed. These problems are audit evidence problems rather than accounting interpretation problems, although we also find omissions of certain disclosures provided by entities even though those disclosures are required by accounting standards. We do not agree with view (c) that a loss should be recognised on all acquisitions, primarily because the key reason for making an acquisition is to enhance the performance of the acquiring and acquired entity and therefore one would expect synergies and intangible assets to be identified in the combination. Recognising a loss although clean and simple suggests an erosion of operational performance in the combination which is possible however it should be that the opposite is true, otherwise why undertake the combination? We also do not support view (a) because the nature of PSEs is mostly to utilize government resources to deliver services to the public which are by nature not net cash generative. For these reasons we therefore support view (b) and agree that for acquisitions NUCC a definition of goodwill that encompasses the notion of service potential is developed.

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).

Consistent with IFRSs we do not agree with the recognition of internally generated goodwill therefore in an acquisition UCC we would not recognise goodwill. In theory PSEs UCC should apply consistent accounting policies therefore any differences arising in an acquisition UCC should be measurement differences rather than recognition differences. Any changes in these measurement differences in the future will be recognised in the statement of financial performance therefore we agree with view (a) that any measurement differences arising on acquisition should also be recognised in the statement of financial performance.

Specific Matter for Comment 7
In your view, should the accounting treatment for the recipient and transferor of an acquisition UCC be symmetrical?

Yes. For reasons of comparability, accountability and transparency it is undesirable for PSEs UCC to adopt inconsistent accounting treatments.

Yours faithfully

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