EUROPEAN COMMISSION
Budget

The Accounting Officer of the Commission

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**NOTE FOR THE ATTENTION OF PROF ANDREAS BERGMANN,
CHAIR OF THE INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD**

Subject: Consultation on the Public Sector Combinations paper

Thank you for the opportunity to comment on your consultation paper on Public Sector Combinations (PSC). The following comments are made in my capacity as Accounting Officer of the European Commission responsible for, amongst other tasks, the preparation of the annual consolidated accounts of the European Union which comprise more than 50 European Agencies, Institutions and other European Bodies with an annual budget of more than EUR 140 billion. Given our experience in defining and implementing the accounting framework for a large governmental organisation with a significant number of consolidated bodies, I believe that our input can be of value to the work of the IPSAS Board in this matter. I would stress, that this note does not represent a communication of the European Commission or any other Commission's service, rather it is my professional opinion on the consultation paper issued.

First of all, I would like to express my satisfaction that the IPSAS Board has addressed the issue of PSCs and issued some preliminary views on that topic. The transfer of operations either as acquisition or as amalgamation under both control distinctions has happened relatively often in the European Union institutions in recent years. This is due to the fact that the EU's enlargement process and the constantly increasing political activities on Union level have often triggered reorganisations that are described by your consultation paper. It is expected that these kinds of PSCs will continue to happen for us in the future.

As there was in the past no specific accounting guidance for PSCs available we had to look at generally accepted private sector guidance. In our opinion this did not fully reflect public sector reality and specificities. So it was necessary to adjust the existing guidance to our needs. Looking at the discussions that the IPSAS Board had so far on this we are confident that you will have a high quality standard on PSCs available in due time. We would like to stress the importance of disclosures on PSC transactions as these are often the most important source of information for addressees such as Parliamentarians. We do, however, understand your reasoning in deferring this topic until the accounting treatment is defined.

As regards your **specific matter for comment 2** we do think that the distinction between acquisitions and amalgamations based on the control criterion[1] and the further differentiation in transactions under common control (UCC) and not under common control (NUCC) is appropriate in respect to the understanding of possible transactions in the public sector. However, the concept with the four sub-cases is at first sight difficult to understand and leads to the situation that the public sector standard becomes more difficult than the private sector standards. For the development of a future standard we would encourage the Board, based on our comments hereunder, to **simplify** the subcases. As regards recognition, measurement and comparatives, we believe that only two cases need to be differentiated[2]:

- Acquisitions NUCC where consideration is transferred; and
- All other PSCs.

In particular the acknowledgement that there are many cases where no acquirer can be identified and that in addition in the vast majority of our past cases no consideration has been transferred is important in the public sector context.

We believe that it is appropriate that all acquisitions should be recognised in the financial statements of the recipient on that date the recipient gains control which corresponds to your **preliminary views 4 and 6**. We agree that this best reflects the substance of the transaction and that it corresponds with the concept of the acquisition method.

Regarding the measurement bases for acquisitions (**specific matter for comment 4**) we are of the opinion that the **modified acquisition method (approach B)** best reflects the economic reality of both acquisitions UCC and acquisitions NUCC. We understand that the Board has taken the **preliminary view 7** that acquisitions UCC should be recognised at carrying amount and we fully support that view for the same reasons mentioned in the consultation paper. As regards acquisitions NUCC, we believe as well that the modified acquisition method leads to a fair presentation of the accounts of the recipient. The statements in the following paragraph relate to acquisitions NUCC without consideration as we believe that when a consideration has been transferred, the application of the "normal" acquisition method is appropriate.

We would in particular point out that an acquisition NUCC **without consideration** is public sector specific and it makes sense to differentiate in terms of accounting approaches. Many of the arguments for our preferred approach in the case of acquisitions NUCC are in principle already expressed in **paragraphs 5.18-5.23** in your consultation paper. We do not believe that for acquisitions NUCC without consideration the transferred fair value has information advantages as compared to the carrying amount approach. One of the main reasons for revaluing net assets of the operations received is to allocate the consideration transferred to the items for which the acquirer has paid more than the book value of the net assets. The fact that no consideration has been transferred or intended to be transferred to the transferor indicates that no real economic change has taken place. This would in particular be true in cases where the transfer was imposed by governments and both the transferor and the recipient had no choice to do so. It could and indeed has happened that operations of an entity controlled or jointly controlled[3] by EU member states that is not an EU institution may be transferred to the EU institutions as a result of a political agreement of the member states[4] independently of efficiency

1 Control over the resulting entity.

2 Based on the modified acquisition method for acquisitions NUCC, the modified pooling of interest method for amalgamations and on an appropriate solution for the goodwill issue.

3 The same applies to operations of Joint Ventures between the EU and other supranational organisations that are transferred into the economic entity EU.

4 In this case there would not be an amalgamation as suspected in para. 3.12 since there is no common economic entity and the economic entity EU would gain control.

gains or the delivery of better quality of service, which is always the intention behind the transfer. This case is in fact very similar to the "normal reorganisation" as in the scope of acquisitions UCC. We thus believe that in our specific cases the discrimination based on the control criteria in IPSAS 6 should not lead to a different accounting treatment of similar transactions. Consequently, accountability should be assessed on the same basis as before the PSC.

We would also like to point out that the "carrying amounts" under approach B may include fair values (e.g. financial instruments) depending on the asset / liability category. So a general statement that approach B would not provide relevant information is incorrect. Likewise the argument implies that the application of IPSASs without PSC does not provide relevant information which is clearly not the case. In some cases, reliability of information should be given more weight since in the public sector some assets are unique and so no valuation technique can deliver useful results, or some transactions might be unique and no input for valuation models can be found. In those cases it is questionable whether an artificial fair value provides more relevant and reliable information.

For public sector combinations in the form of amalgamations we fully support the **preliminary view 8** of the Board to apply the **modified pooling of interest method** of accounting. In particular the concept of combining operations without a transfer of a consideration with the objective of achieving a "merger of equals" is best reflected using the (modified) pooling of interest method and takes the public sector reality into account. We are of the opinion that providing information on the combination of operations as if they had always been combined can be confusing and does not provide addressees of financial reporting with relevant information and thus the proposed modification of this consolidation method is appropriate.

I look forward to our continued co-operation in the area of public sector accounting and remain at your disposal for any question you may have on the above.

Manfred Kraff

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