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Ms Stephenie Fox
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Dear Ms Fox

Consultation Paper - Public Sector Combinations

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board (IPSASB) on the consultation paper *Public Sector Combinations* ("the paper").

HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee is comprised of the senior accounting policy representatives from all Australian States, Territories and the Australian Government.

HoTARAC supports the development of a standard for public sector combinations (PSCs), given that this is not addressed by other International Public Sector Accounting Standards (IPSASs). However, consistent with IPSASB's goal for convergence of IPSASs with International Financial Reporting Standards (IFRS), HoTARAC is concerned that the paper has not been developed based on modifying IFRS 3 *Business Combinations*, and in accordance with IPSASB's *Process for Reviewing and Modifying IASB Documents*. HoTARAC strongly urges IPSASB to consistently apply these rules when developing IPSASs with a corresponding IFRS.

HoTARAC supports the application of the principles of IFRS 3 for acquisitions Not Under Common Control (NUCC) and the development of proposals for the accounting treatment for combinations Under Common Control (UCC), as suggested by HoTARAC in response to IPSASB's ED 41 *Entity Combinations from Exchange Transactions*. While HoTARAC supports the distinction between PSCs NUCC and UCC, the majority of members do not support the distinction between acquisitions and amalgamations. The CP does not provide any public sector characteristics that justify this distinction on a conceptual basis, and notes that the IFRS previously removed the concept of mergers in the superseded IAS 22, on the basis that they rarely occurred. In addition, HoTARAC notes that the International Accounting Standards Board was unable to define the difference between mergers and business combinations for IFRS 3. Instead, HoTARAC suggests an alternative approach for consideration where PSCs are classified as either:

State Government Victoria

- Acquisitions NUCC (based on convergence with IFRS 3); and
- All other PSCs (including PSCs UCC and amalgamations).

HoTARAC further recommends that the scope for a standard on PSCs be broadened to include Government Business Enterprises (GBEs). In Australia some jurisdictions have both for-profit and not-for-profit (NFP) GBEs, and all GBEs are consolidated at the whole of government level. Therefore IPSASBs should be developed to consider including NFP GBEs in the scope of this project.

Comments by HoTARAC on the Specific Matters for Comment in the report are attached.

If you have any queries regarding HoTARAC's comments, please contact Jenny McKinnar from the Victorian Department of Treasury and Finance on +613 9651 5787.

Yours sincerely

Grant Hehir
for **CHAIR**
HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

30th October 2012

International Public Sector Accounting Standards Board (IPSASB)

Public Sector Combinations – Consultation Paper (the CP)

General Comments – Public Sector Combinations

HoTARAC supports the development of a standard for public sector combinations (PSCs), given that this is not addressed by other IPSAS. However, consistent with IPSASB's goal for convergence of IPSASs with IFRS, HoTARAC is concerned that the CP has not been developed based on modifying IFRS 3 *Business Combinations*, and in accordance with IPSASB's *Process for Reviewing and Modifying IASB Documents*. HoTARAC strongly urges IPSASB to consistently apply these rules when developing IPSAS with a corresponding IFRS.

HoTARAC supports the application of the principles of IFRS 3 for acquisitions Not Under Common Control (NUCC) and the development of proposals for the accounting treatment for combinations Under Common Control (UCC), as suggested by HoTARAC in response to IPSASB's ED 41 *Entity Combinations from Exchange Transactions*. However, HoTARAC is disconcerted that IPSASB has not sufficiently justified the UCC approach in the CP.

HoTARAC considers that the use of diagrams and tables as provided in the CP to summarise the proposals is very useful.

However:

- Some HoTARAC members do not support distinguishing amalgamations from other acquisitions.
- HoTARAC recommends clarification on which entity combinations fall within UCC and NUCC. For example, confirmation that UCC includes all public sector entity combinations, including GBEs that are controlled by the government, and that NUCC would include everything else, such as businesses and charities.
- HoTARAC would also recommend providing examples of situations for each proposed distinction e.g. nationalisation and privatisation. This has become prevalent since the Global Financial Crisis e.g. bank nationalisation.
- It is noted that some terms such as 'recipient' and 'transferor' have been aligned with IPSASB 23 *Revenue from Non-Exchange Transactions* rather than 'acquirer' and 'acquiree' as used in IFRS 3, without a strong argument for the deviation from IFRS based on public sector characteristics. HoTARAC recommends the inclusion of a succinct list of definitions similar to the presentation of key definitions in the CP's Preliminary View 1, with the addition of definitions for control and fair value, and/or reference to these terms defined in other IPSAS or IPSASB's *Glossary of Terms*.
- HoTARAC also recommends that IPSASB monitor IFRSs such as IFRS 9 *Financial Instruments,* IFRS 13 *Fair Value Measurement* and IFRS 10 *Consolidated Financial Statements* and may elect to update the CP's definitions in line with the IASB. The

potential impacts of these changes may merit further consideration by IPSASB, and in light of IPSASB's current projects that may potentially change the use of the term control (refer to paragraph 1.11 of the CP).

Specific Matter for Comment 1 (following paragraph 2.49)
In your view, is the scope of this CP appropriate?

HoTARAC agrees with the CP approach to consider a wide range of PSCs. As noted above, HoTARAC supports the IPSASB's consideration of acquisitions UCC as previous raised in the ED 41 response.

However, HoTARAC does not agree that the scope excludes the accounting treatment of a combination in the financial statements of a GBE, based on the assumption that GBEs do not apply IPSASs. In the Australian context, some jurisdictions have both for-profit and not-for-profit (NFP)GBEs. and therefore IPSASBs should be developed to consider NFP GBEs. GBEs are also consolidated at the whole of government level, and therefore should be included in the scope of this project.

HoTARAC notes that IFRS 3 covers subsequent measurement and accounting, which are topics not addressed in the CP. HoTARAC believes that these topics should be considered by IPSASB.

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

HoTARAC supports the approach taken in this CP to distinguish between PSCs NUCC and UCC, as these may require different accounting treatments.

However, HoTARAC has split views regarding whether it useful to consider amalgamations for PSCs as proposed in the CP. Some HoTARAC members are not persuaded by the CP's arguments for distinguishing acquisitions and amalgamation, and do not support this proposed separation in the CP. These HoTARAC members consider that the CP does not provide any public sector characteristics that justify this distinction on a conceptual basis, and notes that the IFRS previously removed the concept of mergers in the superseded IAS 22, on the basis that they rarely occurred. In addition, HoTARAC notes that the IASB was unable to define the difference between mergers and business combinations for IFRS 3. For the distinction to be meaningful for users and in the interest of consistent application by preparers of the principles in the standard, further consideration of a convincing conceptual basis is required to support the proposed distinction.

Further, HoTARAC notes that the CP uses the same accounting treatment for acquisitions UCC and amalgamations (refer to Preliminary Views 7 and 8). Therefore, HoTARAC proposes an alternative approach for consideration where PSCs are classified as either:

- Acquisitions NUCC (based on convergence with IFRS 3); and
- All other PSCs (including PSCs UCC; and amalgamations)

The 'All other PSCs' proposal covers any combinations under UCC without the requirement to distinguish between acquisitions or amalgamations for recognition and measurement purposes. Attachment A reflects this alternative approach based on the CP's Appendix C Public Sector Combinations Flow Chart, and illustrates HoTARAC's preferred accounting treatments as discussed in the specific matters for comment below.

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?

HoTARAC interprets that this question refers to any other characteristics that may distinguish amalgamations from acquisitions. As noted in the comments to Specific Matter for Comment 1 and 2 above, HoTARAC disagrees with the distinction between amalgamations and acquisitions.

In general, HoTARAC believes that the assessment of whether one party has gained control of one or more operations (i.e. a PSC acquisition) should be based on the application of the control concept, which is also examined as part of IFRS 10 *Consolidated Financial Statements.*

In considering control, HoTARAC believes examining the authority (e.g. a government decision/legislation/administrative order/other instrument) or sometimes the contract for the combination is important, in particular the intention of the authority. This is a factor that distinguishes PSCs from private sector combinations where the contract is generally the authority.

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.

HoTARAC supports Approach A for the measurement of acquisitions NUCC and the reasons provided in paragraphs 5.9-5.14 including:

- consistency with other IPSAS where fair value is used to measure acquisitions of individual assets and liabilities, including in non-exchange transactions, and
- enhancement of comparability, and enables users to assess whether the value of any consideration transferred for the operation reflects the values of the operations net assets.

Approach A also aligns with IFRS 3 (paragraph 18), consistent with IPSASB's goal to converge with IFRS unless there are public sector characteristics that would require an alternative approach.

In addition, HoTARAC is concerned that allowing different accounting treatments where consideration is transferred from where consideration is not transferred or transferred at nominal value, may lead to financial statement structuring opportunities.

It should be noted that while HoTARAC supports Approach A for transactions NUCC, HoTARAC agrees with using carrying amounts for transactions UCC.

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).

HoTARAC generally supports option (c) on the basis that excess consideration for net asset transfers for public sector acquisitions NUCC are unlikely to meet the IFRS 3 definition of goodwill. However, a minority of HoTARAC members support option (b), if IPSASB considers a definition of goodwill that encompasses the notion of service potential.

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).

HoTARAC supports option (b) for the recipient UCC to recognise the difference arising between the consideration transferred (if any) and the net assets acquired or net liabilities assumed in net assets/equity as a contribution from owners or a distribution to owners. This is consistent with the treatment in Australia in AASB 1004 for administrative restructures. Typically, the driver for the combination is to meet the owner government's policy objectives, therefore any differences should be recognised by the recipient through an adjustment to owner contributions or distributions to owner.

Questions also arise as to what is the appropriate measurement basis for such transfers. Preliminary View 7 in the CP implies that the recipient recognises the transferred assets/liabilities with amounts adjusted to align with their own accounting policies. This reflects the fact that the CP has not reached a conclusion as to the measurement basis to apply for acquisitions (para 6.9).

Similarly in Australia, AASB 1004 does not specify the measurement basis to be adopted for assets and liabilities transferred in the course of an administrative restructure. As a result, the assets and liabilities transferred could be measured at fair value or book value. Some Australian jurisdictions, in mandating fair value (i.e. based on fair value to the transferee), require any adjustments to the carrying amount of the transferred assets and liabilities to be first recognised by the transferor entity prior to transfer. This ensures that the net equity transferred out from the transferor entity equals the net equity transferred to the transferee entity, consistent with transactions within a wholly owned group.

Also in Australia some jurisdictions effect transfers of the net assets/liabilities between entities UCC, first through an intermediary owner entity, typically departments on behalf of the government or a Crown entity. Where such an intermediary owner entity is used, HoTARAC recommends for the initial transaction between the transferor and the intermediary owner entity, that the net assets/liabilities of the operation be transferred at carrying amounts through contribution/distribution to owner. While the intermediary owner entity has control over the operation's net assets, HoTARAC recommends that their carrying amounts be revalued where necessary to reflect either the mandated fair value (if applicable) or any adjustments to align with the PSC recipient's accounting policies. The intermediary owner entity would then transfer these adjusted net asset/liability carrying amounts as owner contributions/distributions to the PSC recipient entity, reflecting that typically it is the owner government, and not the transferor/recipient entities, that decide to transfer an operation between entities UCC.

HoTARAC strongly recommends that the CP clarify these recognition requirements.

In addition, given the IPSASB's current work program on its Conceptual Framework, HoTARAC recommends that IPSASB consider whether the difference arising would meet the definition of each element considered in Phase 2 of the Framework, such as gain, loss, contribution from owners, distribution to owners, revenues and expenses.

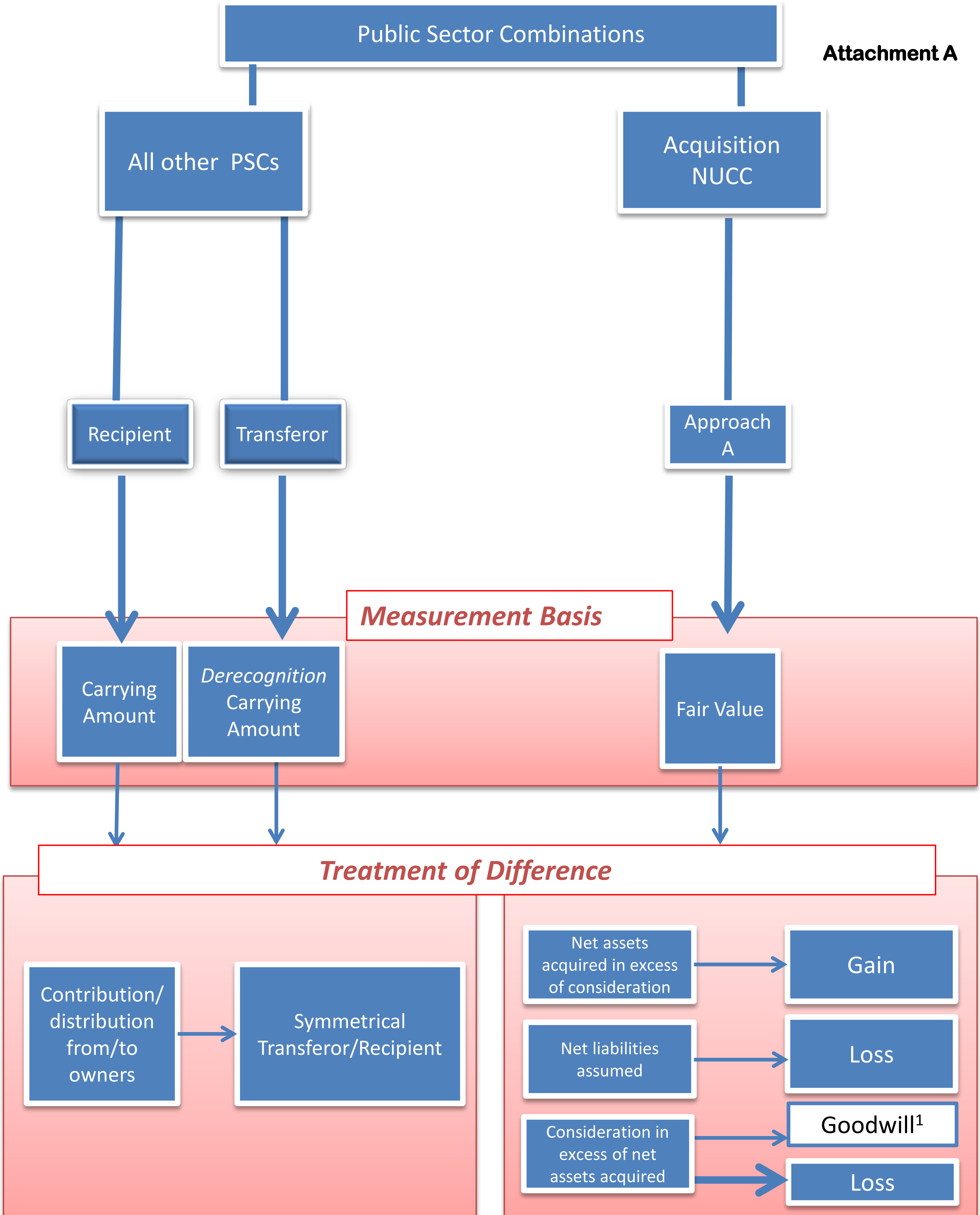
Specific Matter for Comment 7 (following paragraph 6.31)

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

HoTARAC strongly believes that in accounting for an acquisition UCC, the accounting treatment for the recipient and transferor should be symmetrical, as at the whole of government level there has been no change to the assets or liabilities subject to the combination. This also aligns with the Government Finance Statistics (GFS) approach.

Symmetry can be achieved by both the transferor and the recipient recognising a contribution from owners or distribution to owners of the same amount. This can be achieved either by transferring net assets at the transferor's carrying amount, or by requiring the transferor (or where applicable the intermediary owner entity) to adjust the carrying amount to the recipients fair value and /or to align with accounting policies immediately prior to transfer to the recipient.

Attachment A



1. Minority view on proviso that a suitable definition of goodwill can be developed for the public sector.