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31 October 2012

Stephanie Fox,
IPSASB Technical Director,
International Public Sector Accounting Standards Board,
International Federation of Accountants,
277 Wellington Street West,
Toronto, Ontario M5V 3H2,
Canada.

Dear Madam:

RE: CONSULTATION PAPER - CONSULTATION ON PUBLIC SECTOR COMBINATION

The Institute of Certified Public Accountants of Kenya (ICPAK) welcomes the opportunity to comment on the Consultation Paper Public Sector Combination issued by the International Public Sector Standards Board (IPSASB) of the International Federation of Accountants.

The Institute believes that the need for guidance in the area of public sector combinations is both relevant and timely. The IPSASB's efforts to address these issues are critical and will help to ensure that accounting for such transactions is consistent and that the results are useful. The Institute supports the approach suggested in the Consultation Paper of accounting for such transactions as either an acquisition or an amalgamation. This is similar to an approach proposed by GASB in their recent exposure draft *"Government Combinations and Disposals of Government Operations"* where it was proposed that transaction be accounted for as either an acquisition or a merger. The presence of consideration is a factor in determining whether an acquisition has taken place for both GASB (the determining factor) and IPSAS (characteristic among others) to be considered.

Following are ICPAK's response to the areas for specific comment.

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

We believe that the scope of the CP is appropriate to address the matter of Public Sector Combinations.

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.

The approach outlined in the CP provides a basis for classifying transactions that do reach the goal desired by the IPSASB. However we believe that the IPSASB should consider adopting a framework for classifying the transaction as either an acquisition or an amalgamation using criteria similar to that used by GASB in its recent exposure draft on public sector combinations.

The approach used by GASB was centered on the concept of whether or not the transaction involved the exchange of significant consideration, rather than whether or not one entity obtained control over another entity. This approach also appears to align with the accounting approach suggested in the Consultation Paper if Alternative B for acquisitions is used. In this approach, only transactions that involve the exchange of consideration will result in items being recognized at "fair value". In all other instances, the use of "carrying values" is the suggested method for recording transactions. It would seem logical to align the accounting with the classification of the transactions.

ICPAK does have a concern regarding one aspect of the Consultation Paper's approach for classifying transactions as either an acquisition or an amalgamation. we believes that using control to classify transactions poses many challenges and provide the following examples:-

Paragraphs 3.2 and 3.12 provide that an amalgamation that occurs when a combination is imposed on one level of government, call it A, by another level of government, call it B, even though B does not control A. The CP states that the imposition is possible because B can direct A to do it. To us, the ability to direct the action of A is an indication of control in addition; other characteristics are listed in paragraph 3.13 that also may be present in a combining transaction that might tilt the transaction to being classified as an acquisition. Naturally very few transactions shall be balanced in such a way that one entity may not have some advantage over another entity in size or representation in the new amalgamated entity when the transaction has been completed. While we recognize that professional judgment shall be involved in any such determinations, we would suggest that the IPSASB provide some additional guidance in this regard.

We suggest that IPSASB's adopt an approach similar to GASB's proposal to classify transactions based upon the exchange (or lack of an exchange) of significant consideration between the entities in the transaction. This type of monetary approach to classifying transactions would result in a simpler classification approach than the approach suggested in the CP.

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 would prefer if the IPSASB focused its classification of the transaction as either an acquisition or an amalgamation on the presence of significant consideration rather than a matter of control after the combination is complete. In this case, the distinction between amalgamation and acquisition would be based upon whether an exchange of significant consideration is present within the combination transaction.

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.

ICPAK supports approach B in accounting for acquisitions. We believe that where significant consideration has been exchanged, an acquisition has been executed and the transaction should be accounted for using a fair value measurement approach. We believe that this aligns the accounting with fundamental nature of the transaction. As we reviewed the Consultation Paper, we found that if approach B is adopted related to acquisitions, there is little distinction between the accounting treatments for most transactions, except for an acquisition where consideration has been exchanged. The accounting for amalgamations and acquisitions without consideration seems to be on a similar basis and adds a level of complexity to the accounting issues that may not be warranted.

5. In your view, where the consideration 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 believe that where necessary a gain or a loss should be recognized in all cases provided the gain or loss is computed using fair value and not depreciated historical costs. We are not for the inclusion of goodwill in the public sector environment since no goodwill is expected to be derived from operations of public sector entities.

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).

ICPAK supports option (b). The approach suggested by the IPSASB for these transactions is to use the carrying values as the measurement basis for the transactions. We believe that as carrying values may or may not reflect fair value, it would be inappropriate to recognize either a gain or a loss on such transactions. Therefore, approach (b) should be used.

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

ICPAK believes that the accounting for the recipient and the transferor should be symmetrical.

We would like to thank you for allowing us to submit our comments to the exposure draft. Should there be any questions regarding our comments, please contact Nixon Omindi at nixon.omindi@icpak.com

Yours sincerely,

Nixon Omindi
For: ICPAK-Professional Standards Committee