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Australian Accounting Standards Board

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30 June 2016

Mr John Stanford
International Public Sector Accounting Standards Board
277 Wellington Street West
Toronto, Ontario, M5V 3H2
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Dear John,

IPSASB ED 60 *Public Sector Combinations*

The Australian Accounting Standards Board (AASB) welcomes the opportunity to provide comments on IPSASB ED 60 *Public Sector Combinations* ('the ED'). In formulating its comments, the AASB sought and considered the views of Australian constituents through targeted outreach.

The AASB supports the IPSASB's efforts in addressing public sector combinations. However, the AASB has some concerns regarding the classification of some combinations as amalgamations. In particular, the AASB does not agree that public sector combinations with private sector entities should be classified as amalgamations. In the AASB's view, such combinations should always be accounted for as acquisitions.

The AASB also does not agree that the modified pooling of interests method for amalgamations achieves comparability between current period and prior period operating results. In the AASB's view such comparability would be best achieved with an unmodified pooling of interests method. However, the AASB is aware that requiring entities to restate prior periods could be onerous without providing sufficient benefit to users. In that case, the AASB suggests the IPSASB revise the ED to not conclude that the modified pooling of interests method assists in comparability and instead conclude that the modified pooling of interests method was selected for cost / benefit reasons.

The AASB's responses to the specific matters for comment in IPSASB ED 60 are included in the Appendix to this letter. If you have queries regarding any matters in this submission, please contact me or Shaun Steenkamp (ssteenkamp@aasb.gov.au).

Yours sincerely,

K. E. Peach

Kris Peach
Chair and CEO

APPENDIX

AASB comments on IPSASB ED 60 *Public Sector Combinations*

The specific matters for comment in the ED are addressed in turn below. Unless otherwise stated, constituent feedback supports the AASB views.

Specific Matter for Comment 1

Do you agree with the scope of the Exposure Draft? If not, what changes to the scope would you make?

1. The AASB agrees with the scope proposed in the ED.

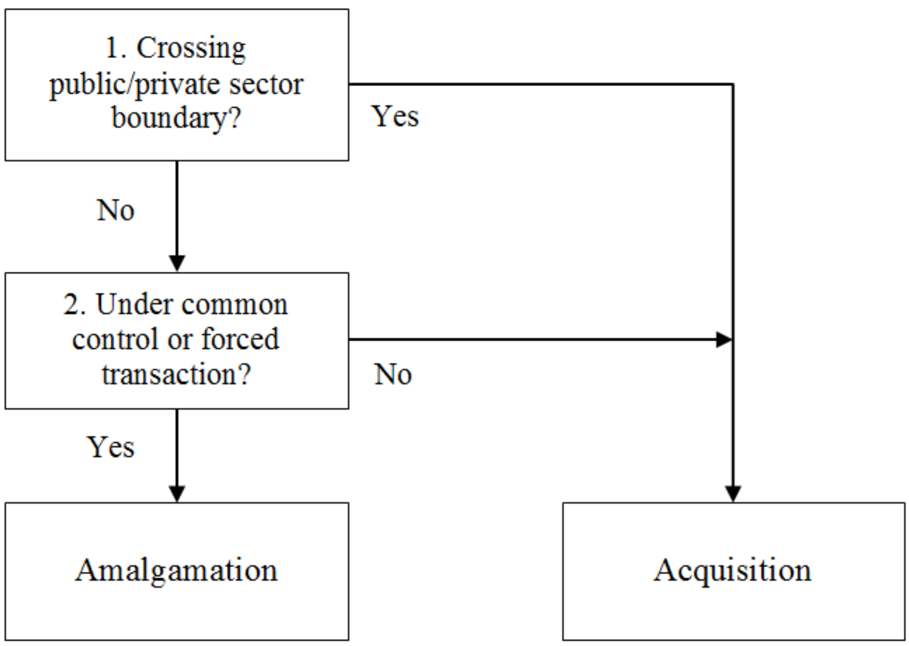
Specific Matter for Comment 2

Do you agree with the approach to classifying public sector combinations adopted in this Exposure Draft (see paragraphs 714 and AG10–AG50)? If not, how would you change the approach to classifying public sector combinations?

2. The AASB disagrees with the proposed approach to classifying public sector combinations.

3. The AASB favours an approach that is more strictly based on the concept of control with some modifications for circumstances unique to the public sector. In this context the AASB has developed a classification approach that could be adopted directly, or be used to develop alternative indicators to the ones proposed in paragraphs 12 and 13 of the ED.

AASB alternative classification approach



Explanation of AASB classification approach

4. The first step in the approach filters business combinations for those that combine public sector operations with private sector operations. The AASB's view is that such transactions would result in the public sector entity gaining control of the private sector entity's operations in the vast majority of cases. In a combination of operations involving a private sector entity, the AASB concurs with the IASB's rationale in IFRS 3 *Business Combinations* that most business combinations are acquisitions and 'true mergers' or 'mergers of equals' are so rare as to be virtually non-existent (IFRS 3.BC27 and BC35).

5. The next step would be to consider the combination of operations only in the public sector and whether those combinations are under common control or are a 'forced' transaction within the public sector (for example a new legislative requirement). In the AASB's view, transactions under common control should be accounted for as amalgamations. The conceptual basis for this treatment is that operations under common control are essentially extracts of a larger operation or entity. Therefore, acquisition accounting would be inappropriate for transactions where the combining operations are merely extracts of a continuing larger operation/entity. The AASB views forced transactions, such as when public sector operations are forced or directed to combine, as akin to a combination under common control. For example, where two local councils are required to combine by legislation passed by the state government even though the state government does not effectively control the councils. Accordingly, those transactions should be accounted for in the same way as combinations under common control i.e. as amalgamations.

6. Constituent feedback indicated an appetite to insert a third step for combinations involving only public sector entities. This step would be to consider the 'substance of the transaction' for combinations not under common control (including 'forced transactions') similar to the IPSASB's rationale in paragraph AG22 of the ED. The aim would be to classify combinations not under common control as amalgamations if the substance of the transaction is that a new entity is formed to assume the operations of the combining entities. If the substance is that one of the parties to the combination continues to exist subsequent to the combination, then this would be treated as an acquisition. The AASB decided not to include this step in the proposed approach above in favour of a simpler classification approach based on common control or akin to common control. The AASB considers that if the proposed approach were to include an economic substance step for combinations not under common control, it could be argued that the accounting for amalgamations would also need to be modified depending on whether the amalgamation is between operations under common control (i.e. extract of continuing entity) or not (i.e formation of new entity). This would add unnecessary complexity to preparers with little added benefits to users of the financial information.

7. In the AASB's view the alternative classification approach above would work conceptually and is sufficiently simple to apply in practice. However, if the IPSASB decides to continue with its proposed approach in the ED, the AASB suggests some modifications to the indicators in paragraphs 12 and 13 of the ED on when acquisition accounting may be rebutted, to achieve an outcome similar to the above classification approach. The AASB suggests the IPSASB:

   (a) remove the indicator in paragraph 12(c) of the ED. This indicator would permit combinations involving private sector NFP entities, like a charity organisation, to be classified as amalgamations. It is the AASB's view that any combination involving a private sector entity should be accounted for as an acquisition.

   (b) remove the indicator in paragraph 13(b) of the ED. The AASB does not think that this is a relevant indicator as it is similar to shareholder approval in the private sector where only acquisition accounting is permitted. Higher-level approval should not be a factor in classification.

Specific Matter for Comment 3

Do you agree that the modified pooling of interests method of accounting should be used in accounting for amalgamations? If not, what method of accounting should be used?

8. The AASB disagrees that the modified pooling of interests method of accounting should be used in accounting for amalgamations.

9. The AASB considers that the pooling of interests method specified in IAS 22 *Business Combinations* and paragraph BC43 of the ED (which requires restated comparatives), which accounts for the combining operations as though they were continuing as before, although now jointly owned and managed is most appropriate for amalgamations, especially given the ED's aim to achieve comparability between current period and prior period operating results.

10. However, the AASB acknowledges that the benefits derived from applying the IAS 22 pooling of interests method might not outweigh the costs. Accordingly, the AASB could accept the modified pooling of interests method on a cost / benefit rationale. If the IPSASB decides to require the modified pooling of interest method for amalgamations in its final standard, the AASB suggests the IPSASB include a cost / benefit rationale for the decision in its basis for conclusions.

11. If the IPSASB proceeds with the modified pooling of interests method the AASB suggests that, where appropriate, reserves be carried forward in the amalgamated entity, as this is consistent with the rationale that amalgamations are continuations of existing entities that are extracts of a larger entity. This would be particularly useful in cases such as the cash flow hedge reserve and asset revaluation reserve.

This is particularly important because of the requirement in paragraph 25 of the ED to adopt the classifications and designations applied by the combining operations. Considering this requirement, the combined entity's financial statements would not faithfully represent those previous classifications and designations if the reserves have been eliminated.

12. In addition, the AASB suggests that the final Standard should not conclude that the modified pooling of interests method assists comparability of current period with prior period results.

Specific Matter for Comment 4

Do you agree to adjustments being made to the residual amount rather than other components of net assets/equity, for example the revaluation surplus? If not, where should the adjustments be recognised?

Do you agree that the residual amount arising from an amalgamation should be recognised:

(a) In the case of an amalgamation under common control, as an ownership contribution or ownership distribution; and

(b) In the case of an amalgamation not under common control, directly in net assets/equity?

If not, where should the residual amount be recognised?

13. The AASB suggests that the IPSASB not prescribe where in equity the residual amount is recognised. Instead, this should be left to entities to determine the most appropriate treatment. This view is also consistent with the IASB's tentative views in the Business Combinations under Common Control project.

Specific Matter for Comment 5

Do you agree that the acquisition method of accounting (as set out in IFRS 3, *Business Combinations*) should be used in accounting for acquisitions? If not, what method of accounting should be used?

14. The AASB agrees that the acquisition method in IFRS 3 should be used in accounting for acquisitions.