ICAEW REPRESENTATION
92/16

Exposure Draft 60 – Public Sector Combinations

ICAEW welcomes the opportunity to comment on the *Public Sector Combinations* exposure draft published by the International Public Sector Accounting Standards Board (IPSASB) in January 2016, a copy of which is available from this link.

This response of 24 June 2016 has been prepared on behalf of ICAEW by its Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the Faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. Comments on public sector financial reporting are prepared with the assistance of the Faculty's Public Sector Development Committee .The Faculty provides an extensive range of services to its members including providing practical assistance with common financial reporting problems.

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MAJOR POINTS

1. In considering the proposals in ED 60 we have borne in mind the general principle that accounting standards should apply to the majority of circumstances and be kept as simple as possible.

2. Considered in the light of this principle, we believe that the current proposals on accounting for public sector combinations are overly complicated. To simplify the approach, we propose to reverse the rebuttable presumption in ED 60 which states that acquisition accounting should be applied unless there are indicators that the combination is not an acquisition. Instead, the presumption should be that the amalgamation method will be applied unless relevant indicators suggest that this is not appropriate. Only if there are indications that the amalgamation method may not provide a true and fair outcome would the preparer be required to assess the substance of the combination.

3. When considering the existence of goodwill, the ED currently differentiates between situations where there is consideration paid and those where there is no consideration paid. As explained below, we believe this distinction to be irrelevant, and open to abuse, such as arrangements being made for the payment of a nominal sum. We suggest that the draft standard is amended to remove the distinction, perhaps rendering paragraph 85 superfluous.

RESPONSES TO IPSASB QUESTIONS

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?

4. Yes, we agree with the scope.

Specific Matter for Comment 2:

Do you agree with the approach to classifying public sector combinations adopted in this Exposure Draft (see paragraphs 7-14 and AG10-AG50)? If not, how would you change the approach to classifying public sector combinations?

5. The current ED overcomplicates the proposed financial reporting of public sector combinations by introducing a requirement for acquisition accounting to be applied when one public sector entity gains control of another, rebuttable in certain circumstances. It is rare for a combination in the public sector to have the economic substance of an acquisition, even where the form of the combination has the appearance of one public sector entity gaining control of another entity. Accounting standards should seek to address the vast majority of circumstances: applying the ‘80/20 rule’ would ensure that standards are generally fit for purpose whilst being as straightforward as possible.

6. The acquisition method will rarely be applied in practice to account for combinations involving two public sector entities, particularly as the vast majority of combinations will be imposed by government in one way or another (paragraph 13a of ED 60). We recommend an alternative, simpler approach to classifying public sector combinations whereby the rebuttable presumption applies only when there are indicators that the economic substance of the combination is that of an acquisition. This reverses the initial presumption, so that amalgamation accounting will apply unless the presumption is rebutted in favour of acquisition accounting, based on relevant indicators.

7. The alternative approach described above simplifies the methodology for classifying public sector combinations by only requiring further assessment of the substance of the combination if there are indicators suggesting this is required. This is in effect a similar approach to that taken in IPSAS 21 and IPSAS 26 on impairments. The indicators of consideration and decision making process as described in paragraphs 12-13 of ED 60 are suitable for this purpose in our opinion, but would need to be inverted to fit with our proposal.

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. We agree that the modified pooling of interest method of accounting should be used for amalgamations. We believe that this methodology is faithfully representative (the loss of fair value information is not a problem in this situation) and would thus allow users of the accounts to evaluate the entity post amalgamation appropriately.

9. Although we would always advocate reliable and relevant financial reporting above any cost considerations, in this case, not having to fair value assets and liabilities seems a sensible outcome in terms of cost: benefit considerations.

Specific Matter for Comment 4:

Part 1: 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 adjustments be recognized?

10. We agree that adjustments as listed in paragraph 38 of ED 60 should be recognised as part of a residual amount, subject to the point made below.

11. Although the ED is not very clear when discussing adjustments in reserves, BC64 states that as the amalgamation gives rise to a new entity, all items in net assets/equity would be included as part of the residual amount. We disagree with the requirement to derecognise the revaluation surplus. Although we appreciate the argument made in BC64, the result would be a continuation of financial statement line items in the top half of the statement of financial position and a discontinuation in the bottom half (reserves). Whilst the combined entity could be regarded as a new entity, the amalgamation approach is partly justified because the entity carries on as before, and therefore maintaining the revaluation reserve is logical. Not maintaining the revaluation reserve would mean an increased likelihood of future revaluation losses needing to be recognised in surplus/deficit as opposed to reserves.

12. Although this point is recognised in BC65, we believe that the potential impact may be substantial and should be given greater significance in determining the make-up of the residual amount.

Part 2: Do you agree that the residual amount arising from an amalgamation should be recognized:

(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 recognized?

13. The question above is in relation to individual accounts of combining entities, something which could be clearer. On that basis, we agree that the residual amount for amalgamations under

common control should be shown as an ownership contribution or distributions and otherwise directly in net assets/equity.

Specific Matter for Comment 5:

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

14. We agree that the acquisition method is appropriate for public sector combinations where there are indicators that the economic substance of the combination is that of an acquisition.

15. However, we do not agree with the statement in paragraph 85 that no goodwill shall be recognised if no consideration is paid and it is difficult to ascertain what principles the paragraph is trying to establish. In our opinion, this paragraph needs substantial modification, or is perhaps not required at all, since consideration paid or not paid is not an issue. If no consideration is paid, the current ED seems to assume that there is no value in the acquired entity, something which should not be the case when acquisition accounting is used.

16. Moreover, the payment or non-payment of consideration is open to abuse (such as paying a notional CU1), and does not influence the creation of goodwill in our opinion. For example, the acquisition of net liabilities without any consideration could still include intangible assets such as customer lists, patents etc. However, currently this scenario would result in a loss recorded in surplus or deficit. However, the payment of just a notional amount would lead to the recognition of goodwill. As long as acquisition accounting is used only in the right circumstances, the recognition of purchased goodwill is appropriate.