The Chartered Institute of Public Finance & Accountancy

Exposure Draft 60
Proposed IPSAS *Public Sector Combinations*

response to exposure draft

29 June 2016

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

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International Public Sector Accounting Standards Board
International Federation of Accountants
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CANADA
Submitted electronically

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Dear IPSASB secretariat

Exposure Draft 60

Proposed IPSAS *Public Sector Combinations*

CIPFA is pleased to present its comments on this Exposure Draft, which has been reviewed by CIPFA's Accounting and Auditing Standards Panel.

CIPFA supports most of the main proposals in the Exposure Draft. Comments are provided in the attached annex.

We do however disagree with the proposals for the treatment of revaluation reserve
We consider that the proposed approach to revaluation surplus is likely to result in valuable information being discarded without clear justification, with possible adverse effects on faithful representation. The benefits of the proposed approach are not explained.

I hope this is a helpful contribution to the Board's standards development process. If you have any questions about this response, please contact Steven Cain (e: steven.cain@cipfa.org, t: +44(0)20 7543 5794).

Yours sincerely

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ANNEX

Specific Matter for Comments

<table>
<tr><td>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?</td></tr>
<tr><td>CIPFA agrees with the scope of the Exposure Draft.</td></tr>
<tr><td>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?</td></tr>
<tr><td>CIPFA agrees with the classification approach adopted in the ED.

However, the explanation around ‘rebuttal’, both in the guidance and the illustrative examples could be made clearer.

Specifically, more explanation is required to distinguish the following two cases:

1) the fact that a combination of public sector entities is imposed by a higher authority such as national government is taken as an indicator that the presumption that an acquisition has taken place can be rebutted;

whereas

2) the imposition of public sector control over a private sector entity is taken to indicate that the presumption should <u>not</u> be rebutted.</td></tr>
<tr><td>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?</td></tr>
<tr><td>CIPFA agrees that the modified pooling of interests method should be used to account for amalgamations.</td></tr>
</table>

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 adjustments be recognized?

CIPFA agrees with most of the proposals in this ED, but on the specifics of this question, we disagree significantly on several counts.

CIPFA disagrees with the framing of this question. Partly because it is not consistent with the framing of the body of the draft IPSAS at paragraph 37, which discusses the *recognition* of the residual amount, not *adjustment*.

In our view, recognition is paramount and needs to be addressed first. The recognition of the residual amount is implicit in the recognition of the assets and liabilities of the resulting entity. It is not an adjustment.

Having said this, we do agree that measurement adjustments may be required to reflect re-measurement due to changes in accounting policy. We can see that there might be concerns over the accuracy and objectivity of valuation adjustments when one of the combining entities moves from the historical cost approach to the revaluation approach, as these do not arise as part of past asset management process. Against this background, CIPFA is content that adjustments which arise from the adoption of common accounting policies for the resulting entity should be taken to the residual amount.

Unlike previous drafts of the ED presented at IPSASB meetings including the December 2015 meeting, and unlike the IASB standard IAS 22 *Mergers and Acquisitions*, the text of ED 60 as issued takes a very different approach to the existing components of net assets/equity in the combining entities.

In the previous draft EDs and in IAS 22, the approach taken reflected the view that, although the resulting entity is a new entity, there is a degree of historical continuity. (This is not the terminology used by the Board, but we would argue that it is a significant aspect of the conceptual justification, inasmuch as the modified pooling approach is justified conceptually.) It is therefore possible to take asset, liability and ownership interest balances forward into the resulting entity with relatively little adjustment: the only adjustments required are those needed to bring the financial statements onto a consistent set of accounting policies. The IPSASB drafts differ from IAS 22 in not requiring the preparation of comparative information; in this sense they draw a different balance between the creation of a new entity and the historical continuity which is the primary basis for the modified pooling approach. This contrasts very strongly with the basis of the 'fresh start' approach, even though some aspects of the reporting are similar.

ED 60 takes a different approach, although it is not particularly clearly explained. Paragraph 37 provides a calculation of the residual amount as a balancing item, without mentioning that this is implicitly de-recognising or adjusting to zero all of the pre-existing components of net assets/equity. It is therefore introducing a new class of 'adjustments' which do not arise from changes to accounting policies.

The effect of the revised approach is more apparent in the worked example on page 147, where revaluation reserve is adjusted to zero in the Resulting Entity. We disagree with this treatment.

The revised approach is also referred to in the Basis for Conclusions at BC62 to 66, which explain that the Board has taken the approach of disregarding the historical information on net assets/equity because the resulting entity is a new entity, and therefore could not have generated a surplus or other component of net assets/equity. In our view, any revaluation surplus that exists at the date of the amalgamation is intrinsically linked to the value of the assets that are now reflected in the Statement of Financial Position of the new entity. We disagree with the arguments put forward in BC62 to BC66 for eliminating any existing revaluation reserve as part of the amalgamation adjustments and urge the IPSASB to reconsider the proposed accounting treatment.

In clear contrast to its discussion of why the Board adopted the modified pooling approach to assets and liabilities, the Basis for Conclusions does not provide any clear explanation as to why adopting the 'no historical balances of net assets/equity' is beneficial.

Furthermore, by removing the revaluation surplus it implies any subsequent fall in valuation is an impairment expense rather than taken within the statement of financial position. This risks misrepresenting reported performance in future years. BC65 notes that 'In coming to this decision, the IPSASB accepted that this approach may have consequences for some entities…' We are not convinced that these adverse consequences are balanced by any benefits.

BC66 provides further comment as follows:

Another consequence relates to amalgamations that take place under common control. The resulting entity will recognize a residual amount but the controlling entity will continue to recognize the previous components of net assets/equity in its consolidated financial statements, giving rise to ongoing consolidation adjustments. The IPSASB did not consider that these consequences outweighed the benefits of adopting the conceptual approach.

CIPFA's view on this is that

- The need for adjustments arises because the consolidated statements reflect the historical continuity and better capture the economic substance.

- We are not convinced that the IPSASB has in fact adopted 'the conceptual approach'. At best, it is one conceptual approach among several.

- The 'benefits' of this reserve accounting approach are unclear

As our final comment, we would note that the main example in the ED reflects the circumstances where two entities combine, with one making adjustments because of moving from the historical cost approach to the revaluation approach.

While we do, as explained, disagree with the example, we would be even more concerned about the implications where two very similar entities combined, each of which already used the revaluation approach, and each of which already used identical accounting policies, so that no adjustments were required. In cases such as this, to require that the balances of revaluation surplus should de-recognised and reframed as part of an undifferentiated residual amount is illogical and reduces transparency to stakeholders.

Specific Matter for Comment 4 (continued) *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?*
CIPFA agrees with these proposals on how the residual amount should be recognized, but in the light of our earlier comments, we have significant concerns over the application of the proposed ED to combining entities which are using the revaluation approach.
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?*
CIPFA agrees that the acquisition method, as so described, should be used in accounting for acquisitions.