PUBLIC SECTOR COMBINATIONS: A NEW CHALLENGE FOR IPSASB

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Abstract: *The International Public Sector Accounting Standards Board (IPSASB) has released in June 2012 a Consultation Paper (CP) entitled "Public Sector Combinations" (PSCs) to initiate discussion on the possible accounting treatment for these events. The purpose of this paper is to examine and to provide an overview, regarding the reactions of various categories of preparers, users, auditors, standard-setters and other interested parties to this CP. The research involves a qualitative approach based on the detailed examination and the content analysis of twenty six comment letters that are collected from the official website of the IPSASB. To this end, we analyse the answers to seven specific matters for comment (SMCs) and nine preliminary views (PVs). This research shows that the proposals generally encounter favourable reactions by the different organizations around the world. Most of the respondents that provide general comments support the need for guidance in this area and provide specific comments for improvement. However, some differences of opinion between respondents have been detected. Furthermore, respondents from France are not satisfied with the provisions of the CP and suggest that the text should emphasize on amalgamations. Another three respondents are of the view that transactions between public sector entities (PSEs) cannot be likened to commercial transactions and recommend the IPSASB to explore more in depth public sector oriented situations. The results of this study indicate that for this standard to be successful, further investigations concerning the PSCs' theoretical and practical implications are necessary. The importance of this topic, as well as the impact of the IPSASB on the government combinations accounting treatment impose the necessity of examining the feedback of worldwide organizations which are interested on this issue. Thus, this paper is original in that it addresses the problem of a possible accounting treatment for PSCs in the standard development process of IPSASB, emphasizing a significant gap in the literature regarding accounting treatment specific for these events.*

Keywords: *public sector combinations; IPSASB; Consultation Paper; comment letters.*

JEL classification: *L32; M41.*

1. Introduction

PSCs are a significant feature in the architecture of the public sector. Thus, the accounting guidance for these restructurings in the governmental environment is very important and necessary. Two fundamental questions follow. How should PSCs be approached from accounting point of view? Should they be treated the same as the business combinations or it should be developed a separate issues paper? Currently there is no international standard to provide specific guidance on the accounting for PSCs. Moreover, apparently the only governments that have a specific standard for these events are Australia, USA and South Africa. The absence of accounting guidance in this area doubtless has contributed to diversity in practice. In times when no international standard exists, International Public Sector Accounting Standard (IPSAS) 6 *Consolidated and Separate Financial Statements*, indicates that guidance on accounting for PSCs can be found in the relevant international or national accounting standard dealing with business combinations. But, this guidance does not address conditions and circumstances that are normally encountered in such events. Furthermore, the adoption of a private sector reporting model such as international accounting standards has been questioned as incompatible with the accountability reporting model for the public sector (Broadbent, 1999; Pallot, 2003; Christiaens, 2004). Thus, users may not be able to obtain the information needed to evaluate the nature and financial effect of a combination that occur in the public sector. Considering this fundamental idea, the need for a specific standard identifying the accounting requirements for these transactions is expressed with a higher and higher voice in recent years.
The IPSASB understands the unique characteristics of governments and the environment in which they operate. Therefore, it has released in June 2012 a Consultation Paper entitled "*Public Sector Combinations*" to initiate discussion on the possible accounting treatment for PSCs in the General Purpose Financial Statements (GPFSs) of entities which prepare their financial statements on an accrual basis. The IPSASB requested comments on all of the matters discussed in the CP by October 31, 2012. We believe that the importance of this topic, as well as the impact of the IPSASB on the government combinations accounting treatment impose the necessity of examining the feedback of various interested organizations on this issue.

2. Public Sector Accounting and the Role of IPSASB

The last three decades have witnessed significant efforts to reinvent the worldwide public sector (Wynne, 2008). The paradigms of public policy-making have changed substantially from the "old public administration", to the "new public management", and finally to the "good governance" perspective. Their implementation by the worldwide governments implies particularly the accrual accounting reform. Thus, public sector financial reporting has been adapted and developed in accordance with the 'New Public Financial Management' and accrual accounting is probably the most obvious phenomenon within this accounting reorientation (Lapsley, 1999; Guthrie et al., 1999). IPSASs are the core of the "global revolution in government accounting" (Heald, 2003). Therefore, there are several authors from the public sector accounting area of research who sustain that national governments must approach them (e.g. Adhemar, 2002; Chan, 2003).

The IPSASB was established in 1997 as an operating component of the International Federation of Accountants (IFAC), being an independent standard-setting body that focuses on the accounting, auditing, and financial reporting needs of PSEs, including national, regional, and local governments, and related governmental agencies. The IPSASB's goal is to serve the public interest by developing and issuing, high-quality accounting standards (IPSASs) and other publications for use by PSEs, other than Government Business Enterprises (GBEs), around the world in the preparation of GPFS. This will consolidate confidence in public sector financial management and will improve the transparency and quality of public sector financial reporting that will result in decision-useful information for users of GPFS. Additionally, a key part of the IPSASB's strategy is to support the convergence of the IPSASs with national public sector accounting standards, International Financial Reporting Standards (IFRSs) and the convergence of accounting and statistical bases of financial reporting where appropriate. Many jurisdictions, governments, and international institutions have already adopted IPSASs—many others are on their way to convergence.

3. Research Methodology

This paper analyses the reactions of preparers, users, auditors, standard-setters and other interested parties to the proposals made by the IPSASB. Therefore, a qualitative approach is used based on the content analysis of the comment letters received by the Board for Consultation Paper *Public Sector Combinations*.
For this research we analyse the answers to seven specific matters for comment and nine preliminary views available in the CP of IPSASB (2012). The sample is consisted of 26 comment letters which are considered by IPSASB members for inspection, and are publicly available on the Board's official website.
In the beginning of the qualitative analysis the comment letters were collected from the official website of the Board and afterwards the research involved a detailed examination of their content. Subsequently we conducted a detailed analysis of the narrative through the content analysis of the text and where appropriate, we have subdivided the comments of respondents that have made several points. A major issue of our survey research resides in grouping the answers, as they were unstructured due to the open-ended type of questions.

4. Feedback Results for Consultation Paper *Public Sector Combinations*

4.1. General Comments

85% of respondents provide general comments. Most of them mention the necessity and the relevance of the project in general, and provide specific comments for improvement. However, the respondents from France are not satisfied with the provisions of the CP. They consider that the critical subject of public-sector entity amalgamations is not sufficiently addressed. Therefore, Cour des comptes does not respond to individual SMCs and PVs. Also, three respondents are of the view that transactions between PSEs cannot be likened to commercial transaction and consider that the CP is inadequately suited to the specific characteristics of the public sector.

Three respondents from Australia support the development of an accounting standard which is consistent with existing requirements of IFRS 3, modified where appropriate, to reflect public sector considerations. Also, other respondents consider that the IPSASB should maintain its view that deviations from IFRS/generally accepted private sector accounting standards are only justified, where the nature of the transactions are different in a public sector context. Moreover, two respondents from Australia consider that a joint project with the IASB would be an appropriate way to move forward on this issue. Other respondents suggest that the IPSASB should continue its work, in connection with the work on the Conceptual Framework and revision of IPSAS 6.

One of the main concerns that the respondents have with the CP is the approach taken in determining the type of PSCs. For instance, respondents from USA and Kenya support the approach suggested in the CP of accounting for such transactions as either an acquisition or an amalgamation. They mention that this is similar to an approach proposed by the Governmental Accounting Standards Board (GASB) in their recent exposure draft on this topic. The presence of consideration is a factor in determining whether an acquisition has taken place for both GASB (the determining factor) and IPSASB (characteristic among others) to be considered. The respondents also comment on: accounting base of acquisitions not under common control (NUCC), acquisitions under common control (UCC), amalgamations; the control criterion for distinguishing an amalgamation from an acquisition; and preliminary views.

4.2. SMC 1: The Scope of the Consultation Paper

Figure 1 below summarizes the overall views of the responses to SMC 1, which were generally supportive. However, there are some organizations which agree that the scope of the CP is appropriate with some reservations. A further three respondents do not specify whether or not they agree with the scope of the CP, but provide comments.

In addition, a large subset of respondents provides suggestions as: supplementing the provisions of the standard with concrete examples that might shed light on the transactions referred to in the draft text; excluding transferor accounting from the scope of the CP; including the GBEs in the scope of this project; and summarizing at a higher level the section that refers to the parties to PSCs which are in the scope of the CP. References to the relevant standard would be also useful to provide additional guidance for accounting treatments for transfers outside the scope of CP. Additionally, some organizations consider that the standard should include guidance in relation with the definition of "operation"; on accounting non-current assets held for sale and discontinued operations; on accounting for an operation by the transferor; for differentiating between assets acquisitions, acquisitions and amalgamations; and whether the requirements for PSCs NUCC also apply to situations where one or more of the parties is not a PSE. Finally, the Swiss Public Sector Financial Reporting Advisory Committee (SRS-CSPCP) suggests that there is a need for a clear demarcation between real mergers on the one hand and the unions and special purpose associations on the other. A clear demarcation towards IPSAS 6 – 8 should also be drawn.

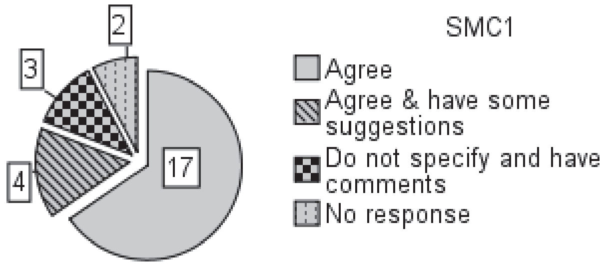

Figure 1: Overview of Responses to SMC 1: The Scope of the CP
Source: Authors' computation

4.3. SMC 2: The Types of Public Sector Combinations

4.3.1. Distinction between Acquisitions and Amalgamations

Figure 2 below summarizes the overall views of the responses to this issue. Thus, 14 respondents support the distinction between acquisitions and amalgamations. However, three of them have the following comments: acquisition transactions where consideration is provided should be distinguished from combinations where no consideration is provided; the distinction between acquisitions and amalgamations should be based on economic substance rather than legal form; the term "acquisition" should be replaced with "transfer of operation".

The CP proposes the control criterion for the distinction between acquisitions and amalgamations. But, several respondents support a different distinction, as follows: using the exchange of consideration criterion; classifying combinations as acquisitions NUCC and all other combinations; the determining factor should be whether or not the combination is voluntary. Moreover, two respondents do not support this distinction. Australian Accounting Standards Board (AASB) thinks that, in practice, the distinction between an acquisition and amalgamation is likely to be difficult in some circumstances. The respondent is not persuaded by the arguments presented in the CP for drawing this distinction. Another respondent from Australia also does not support the distinction as no adequate justification for a public sector difference has been advanced to depart from the principle of acquisition accounting which is the basis of IFRS 3.

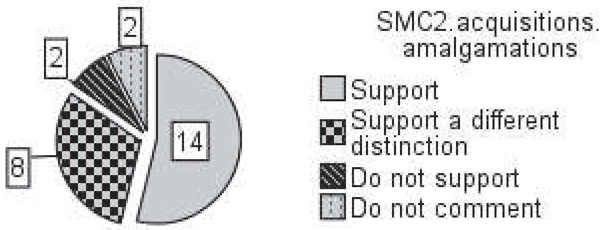

Figure 2: Overview of Responses to SMC 2: Acquisitions and Amalgamations

Source: Authors' computation

4.3.2. Distinction between Combinations NUCC and UCC

Seventeen respondents support the distinction between combinations NUCC and UCC (Figure 3). The rest of respondents do not comment on this issue. Some respondents consider that all combinations UCC should be accounted for as amalgamations. Moreover, two respondents suggest that the accounting treatment for a combination UCC is determined based on whether or not it is voluntary/ whether or not it has commercial substance.

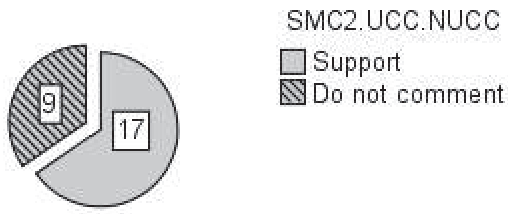

Figure 3: Overview of Responses to SMC 2: Combinations NUCC and UCC
Source: Authors' computation

4.4. SMC 3: Characteristics that Indicate Control

The opinions are divided over the SMC 3 (Figure 4). Eight respondents don't believe that there are other public sector characteristics that should be considered in determining whether one party has gained control of one or more operations. On the other hand, further eight respondents consider that there are also other elements. In addition, some respondents do not believe that control is the sole definitive criterion for distinguishing an amalgamation from an acquisition. Furthermore, AASB disagrees with the distinction between acquisitions and amalgamations and disagrees with the control criterion.

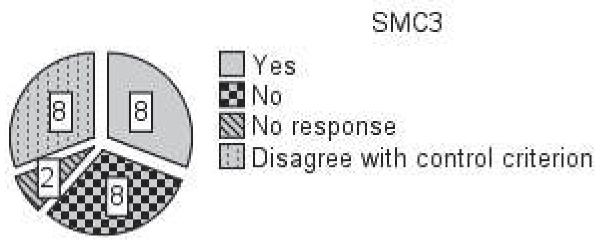

Figure 4: Overview of Responses to SMC 3: Characteristics that Indicate Control
Source: Authors' computation

4.5. SMC 4: Measurement of Acquisition NUCC

38.46% of respondents support approach A: applying fair value measurement to the identifiable assets acquired and liabilities assumed in the operation. Three respondents are concerned that allowing different accounting treatments where consideration is transferred from where consideration is not transferred/ transferred at nominal value, may lead to financial statement structuring opportunities. Other respondents are of the view that approach A is consistent with IFRSs, IFRS 3 and with other IPSAS.

42.31% of respondents support approach B: distinguishing between different types of acquisitions so that for acquisitions where no or nominal consideration is transferred, recognize the carrying amounts of assets acquired and liabilities assumed in the operation, with amounts adjusted to align accounting policies; and for acquisitions where consideration is transferred, recognize the fair value of identifiable assets acquired and liabilities assumed in the operation.

The members of The Japanese Institute of Certified Public Accountants (JICPA) have different views with some members supporting approach A and some members supporting approach B. Two respondents from France do not specify but do not consider fair value measurement to be appropriate. Furthermore, one of them considers that historical cost seems best suited to the public sector. Charity Commission for England and Wales do not specify but comments on each approach (Figure 5).

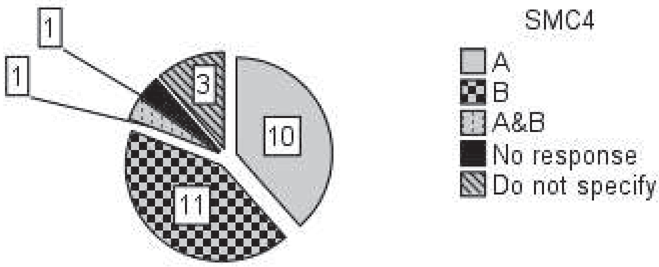

Figure 5: Overview of Responses to SMC 4
Source: Authors' computation

4.6. SMC 5: Accounting for Difference Arising in an Acquisition NUCC

As figure 6 reveals, 22 respondents reply to this SMC. Only five of them support approach (a) – the difference arising in an acquisition NUCC should be recognized in the recipient's financial statements, on the date of acquisition, as goodwill for acquisitions where the acquired operation is cash-generating and a loss for all other acquisitions. On the other hand, eight respondents support Approach (b) – the difference arising in an acquisition NUCC should be recognised as goodwill. Some of them support this approach for consistency with IFRS 3.

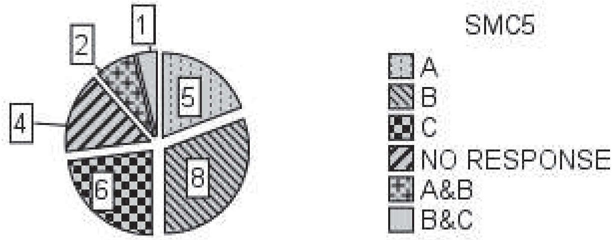

Figure 6: Overview of Responses to SMC 5
Source: Authors' computation
Another six respondents sustain approach (c) – a loss for all acquisitions. Conceptually, Ernst & Young and New Zealand Accounting Standards Board support approach (b). However, from a practical perspective, these respondents support approach (a). Also, respondent from Brazil supports an integrated approach that consolidates the both methods (a) and (b) or to use only the approach (b). Furthermore, Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) from Australia support both (b) and (c) options.

4.7. SMC 6: Accounting for Difference Arising in an Acquisition UCC
23 respondents reply to SMC 6 (Figure 7). Five of them support recognizing the difference arising in an acquisition UCC in surplus or deficit (option A). Ten respondents consider that the difference arising is a contribution from owners or a distribution to owners (option B). New Zealand Accounting Standards Board supports B if some combinations of entities UCC are accounted for as acquisitions. Three respondents support recognizing the difference arising in an acquisition UCC as a gain or loss directly in net assets/equity (option C). Another three respondents make alternative suggestions: a modified version of option C; option B or C chosen as appropriate to the individual circumstances of the acquisition UCC; option A or B based on whether or not the acquisition UCC is voluntary. Conseil de normalisation des comptes publics from France rejects all three options, considering that acquisitions UCC are infrequent. Finally, Chartered Institute of Public Finance and Accountancy (CIPFA) does not specify and questions whether acquisitions UCC occur.

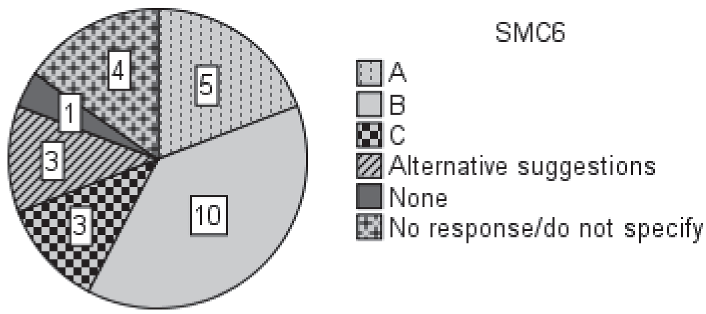

Figure 7: Overview of Responses to SMC 6
Source: Authors' computation

4.8. SMC 7: Symmetrical Accounting for an Acquisition UCC

All 24 respondents that reply to SMC 7 consider that the accounting for the recipient and the transferor of an acquisition UCC should be symmetrical. There are different reasons mentioned by the respondents in favour of the symmetry. However, two respondents do not comment on this SMC.

4.9. Preliminary Views

In addition to the SMCs the CP has 9 Preliminary Views (PVs). The first two PVs propose the definitions for the future standard. The PV 3 states that the sole definitive criterion for distinguishing an amalgamation from an acquisition is control.

The PV 4 and the PV 5 relate to acquisition NUCC. Thus, an acquisition NUCC should be recognized in the financial statements of the recipient on the date the recipient gains control of the acquired operation (PV 4); and the recipient in an acquisition NUCC recognizes in its financial statements on the date of acquisition, the difference arising as a gain where the recipient acquires net assets in excess of consideration transferred (if any) and a loss where the recipient assumes net liabilities. The PVs that relate to acquisitions UCC are PV 6—recipient recognizes acquisition UCC when it gains control and PV 7—recipient uses carrying amount in acquisition UCC. Finally, the last PVs relate to amalgamations: PV 8—resulting entity applies modified pooling of interests method in an amalgamation and PV 9—combining operations continuing to present GPFSs on going concern basis where resulting entity will fulfill responsibilities of those combining operations.

In general, the feedback regarding PVs is not very positive, as there are few respondents that comment on them (Table 1). Moreover, AASB has strong reservations relating to all of the PVs. However, both respondents from Canada and The Public Sector Committee of the Institute of Chartered Accountants of Scotland (ICAS) agree with the PVs/direction taken in the PVs.

Table 1: Overview of Responses to Preliminary Views

	PV1	PV2	PV3	PV4	PV5	PV6	PV7	PV8	PV9
Agree	5	7	6	8	6	8	9	8	7
Disagree	3	1	2	1	2	1	1	2	1
No response	18	18	18	17	18	17	16	16	18

Source: Authors' computation

5. Conclusions

This study outlines a global picture of the reaction of the accounting worldwide community to the IPSASB proposals regarding accounting treatment for PSCs. The IPSASB has received 26 comment letters for the CP of accounting for such transactions, in which are requested seven SMCs and nine PVs. This research has found that generally the respondents welcome the fact that the IPSAS Board has included the subject of PSCs on its agenda and support the development of a standard for PSCs and the approach suggested in the CP.

However, some differences of opinion between respondents have been detected. Moreover, Cour des comptes does not respond to any SMCs because CP emphasizes exchange acquisitions and instead should explore in depth public sector oriented situations. Additionally, the feedback regarding PVs is not very positive, as there are few respondents that comment on them. The results of this research support the idea that for this standard to be successful, further investigations concerning the PSCs' theoretical and practical implications are necessary.
An important generalization of this study is that an accounting and financial reporting standard designed for the combinations arising in the government environment is essential because PSEs are basically different from for-profit entities. The guidance that is currently being applied to government combinations does not address conditions and circumstances that are normally encountered in combinations of PSEs. Thus, there may not be consistent or appropriate reporting of such combinations in the financial statements of public sector bodies. Also, it is important that such a Consultation Paper is being circulated for comment, because in different countries (e.g. Switzerland, United Kingdom, Scotland) PSCs are becoming more frequent.

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