

EFRAG discussion paper

Accounting for Business Combinations under Common Control

response to consultation

30 April 2012

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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.

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Dear EFRAG secretariat

EFRAG discussion paper

Accounting for Business Combinations under Common Control

CIPFA is pleased to present its comments on the matters discussed in this paper, which have been reviewed by CIPFA's Accounting and Auditing Standards Panel.

CIPFA is a professional accountancy body in the United Kingdom which specialises in the public services. In this context we are interested in the development of financial reporting standards both as they apply to the private sector and as they might be applied in or otherwise affect reporting in the public sector. CIPFA has regard to financial reporting issues both as they impact on the United Kingdom and on public sector bodies and wider public services internationally.

Why the public sector is a relevant stakeholder in discussions relating to IFRS

The public sector is a relevant stakeholder in IFRS standard setting, even though the initial focus of those standards is the for-profit company sector and related entities which the Board characterises as public interest entities.

International Financial Reporting Standards are used (with some adaptation) by governments and government bodies in the United Kingdom, Australia, New Zealand and other countries. Furthermore, the principal international standard setter for public sector financial reporting is the International Public Sector Accounting Standards Board (IPSASB), which initially based its standards on relevant IFRS, and still maintains a close read across between its standards and IFRS where these relate to matters which are common to both sectors. The IASB and IPSASB have maintained a dialogue on standards matters.

More generally, CIPFA responds to the majority of IASB consultations and exposure drafts, reflecting our understanding that the public sector, not-for-profit and for-profit sectors are each very economically significant and transact enormous volumes of business with each other.

Ideally standards would be developed in a sector neutral manner, so that differences in the application of standards to reporting entities in different sectors reflect systematic and properly understood differences in the economic characteristics of those entities, and also the differing requirements and priorities of the users of financial reporting in the sectors. Against this background, we accept that the IASB will be primarily driven by the concerns of listed companies.

The specific public sector and wider non-profit sector relevance of combinations under common control

As noted in the discussion paper, combinations under common control are scoped out of IFRS 3 *Business Combinations*.

This scoping out is an issue for the UK public sector; the predominant form of government re-organisation over the last two decades has been 'machinery of government' changes whereby existing functions of government are re-allocated to restructured government bodies, and in some cases additional functions are placed with the new bodies. Other public sector combinations have involved restructuring local government bodies so that they cover different geographical areas, or combine the delivery of related public services in a different way. Other combinations have been more straightforward cases where two or more bodies have combined or merged with each other, or a smaller body has been absorbed into another body. A large number of combinations have been under common control. Under UK GAAP, most accounting for reorganisation has been done using merger (or 'pooling of interests') accounting rather than acquisition accounting. While the UK public sector has moved to IFRS, the lack of coverage of common control combinations in IFRS 3 *Business Combinations* has left government bodies without relevant guidance applicable to the majority of government entity combinations.

UK public sector practice on adapting IFRS for government has been to follow the legacy UK GAAP accounting which encompasses both merger/pooling and acquisition approaches. In practice merger accounting is used in all cases where there is common control.

Accounting for combinations is also relevant to governments in many other countries. Recognising this, the IPSASB is currently developing an *Entity Combinations* standard which is informed by IFRS 3 *Business Combinations*. One of the approaches being taken in that work is to consider common control as the principal basis for distinguishing 'acquisitions' from other types of combination that might not be accounted for in the same way.

This discussion is also interesting for wider categories of non-profit entity (such as charities in the UK), who have had problems in finding resonances with the IASB discussions of acquisitions as the dominant mode of business combination. Non-profit entities are very clear that many and probably most of the combinations in their sector are not acquisitions of an acquired entity by a dominant acquiring entity. Part of the reason for this may be because the combinations are conducted between entities which share objectives, and based on these shared objectives the characteristics of entity combinations may be more like the situation where entities under common control combine, in contrast to acquisitions where control becomes vested in a dominant acquiring entity.

Specific comments on the EFRAG discussion paper

Generally we agree with the analysis set out in the EFRAG Discussion Paper. As the paper sets out conflicting positions on key issues, we do not agree with all such positions.

Perhaps our main comment on the paper has already been made – this is an issue which is also important for the public sector and wider non-profit sector.

However, we have other significant comments to make which reflects on question 3.3 on the application of the IAS 8 hierarchy, and questions 2.3, 3.4, 3.5, 4.1, 4.2, 4.5, 4.8, 4.9, and specifically 5.1 to 5.8 inasmuch as they reflect on the application of IFRS 3 by analogy.

In respect of question 3.3, CIPFA agrees that the development of accounting approaches for BCUCC should be based on the principles of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to ensure that any accounting approach is consistent with the Conceptual Framework and with other parts of the existing IFRS literature which deal with measurement.

In addition, we strongly agree with the careful approach which EFRAG has taken to considering whether, in line with the IAS 8 hierarchy, IFRS 3 *Business Combinations* might be applied by analogy to circumstances outside of the scope of IFRS 3.

In CIPFA's view a careful approach is necessary because the IASB has developed IFRS 3 to address a specific information gap or information need in specific circumstances.

- In CIPFA's view, there are certainly combinations under common control which occur under very different circumstances to those envisaged by the IASB, and the Board's scoping out of common control from IFRS 3 largely reflects their concern that this might be the case.
- It is a separate question as to whether, notwithstanding any difference in circumstances, an IFRS 3 approach would provide useful information, or whether different information would be appropriate, either in principle or on cost-benefit grounds. CIPFA is not convinced that the IFRS 3 approach provides appropriate reporting under all circumstances.

In making these comments, CIPFA has had regard to the rationale presented by the UK Accounting Standards Board (ASB) when developing separate treatments for mergers and for acquisitions in its FRS 6 standard within UK GAAP. Broadly speaking

- Mergers (characterised as reflecting combinations between equal partners) were not considered to represent a significant shift in control arrangements, and for that reason it was appropriate to structure the accounting mainly to reflect accounting as if the merged entity had always existed, and there was no special reason to re-measure the assets or liabilities of the merged entity. The ASB also allowed that this treatment could be applied to group reconstruction, presumably because even though they might not formally satisfy the tests for a merger, the common control exercised at group level meant that there was no significant shift in control arrangements.
- In other cases – i.e. acquisitions – a shift in control was considered to occur at the time of combination. It was therefore important to structure the reporting to mark the transition to the new control arrangements. Furthermore, in the light of the changes to control, information based on the carrying value in pre-combination entity accounts could not be guaranteed to provide sufficiently useful information for the new combined entity or for other stakeholders interested in investing in or otherwise transacting with the combined entity.

In the light of the above, we consider that the IASB (and therefore EFRAG in the context of this work) should consider whether it is possible and appropriate to develop a relatively low cost reporting approach for entity combination reporting in cases where there is no significant shift in control arrangements. This might be modelled on the merger or pooling of interests model.

I hope this is a helpful contribution to the development of guidance in this area.

Yours faithfully

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