

Warren Allen, Chief Executive
External Reporting Board
Email: submissions@xrb.govt.nz

27 May 2016

Dear Warren

Auckland Council submission to ED 60 Public Sector Combinations

Thank you for the opportunity to comment on the proposed Public Sector Combinations.

Auckland Council is Australasia's largest local government entity and is made up of the Council and six substantive council controlled organisations. We invest heavily in infrastructure and many of our decisions will have a fiscal impact on Auckland's future generations.

We believe that the proposed exposure draft is well written and comprehensive for the public sector. We appreciate that the International Public Sector Accounting Standards Board (IPSASB) has included a detailed guideline for amalgamations, which the current standard doesn't have.

We have given our responses to the specific questions for the respondents as an attachment to this letter along with our additional comments for the IPSASB and XRB's consideration.

The responses in this letter were also reviewed and agreed with Watercare Services Limited and Auckland Transport, two of the council controlled organisations.

Once again, thank you for the opportunity to comment.

Yours sincerely



Kevin Ramsay
General Manager Corporate Finance
and Property
AUCKLAND COUNCIL



Francis Caetano
Group Financial Controller
AUCKLAND COUNCIL

Attachment – Auckland Council’s Responses to Specific Matters for Comment requested for Exposure Draft 60 Public Sector Combinations

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

Auckland Council’s response:

We agree with the scope of Public Sector Combinations which now includes amalgamation and combinations under common control.

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?

Auckland Council’s response:

We agree with the approach to classifying public sector combinations which include rebuttable presumptions in cases where one party to the combination has control over the other. Using the rebuttable presumptions requires judgement, however, the public sector will benefit from less costly modified pooling of interests accounting compared to acquisition accounting where fair value is required.

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?

Auckland Council’s response:

We support the modified pooling of interests except for the treatment of revaluation reserves, as discussed further in number 4 below.

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 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?

Auckland Council’s response:

In both cases above, we believe that the revaluation reserves relating to balance sheet items (i.e. revaluation surplus) should be carried forward by the resulting entity and should not be recognised directly in net assets/equity. In modified pooling of interests method, the parties to the combination align to the accounting policies of the resulting entity. Often, the resulting entity will continue to follow the accounting policies of the combined entities. If the combined entities are using the revaluation model for subsequent measurement of PPE, financial instruments, etc., the amalgamation of the entities should not hinder the continued use of the revaluation surplus.

The purpose of the amalgamation in public sector is to render a more efficient service to the community by combining operations, including the accounting policies and the accounting treatments of the respective combining entities.

If the resulting entity cannot use the accumulated revaluation surpluses of the combining entities, this may lead to unintentional consequences. For example, should the subsequent valuation of the assets result in a revaluation loss that will be reflected in the “surplus & deficit”. Accordingly, the resulting entity will carry the unnecessary burden of having to discuss and explain to the community why a loss on revaluation needs to be reflected in the income statement just because the two entities amalgamated. This in fact occurred with one class of assets at Auckland Council shortly after the amalgamation of the Auckland legacy councils. In our view, this proposed treatment is not suited to the wide users of public sector financial statements.

If the proposed treatment of revaluation reserves is left unchanged, this will impact New Zealand public sector entities because the Crown and the local governments use the revaluation model in the subsequent measurement of their PPE. PPE is a significant asset of these public entities. Auckland Council Group’s PPE is 92% of the total assets as at 30 June 2015. Further, recently the market value of the properties in New Zealand has been volatile which greatly impacts the current revaluation movements of Auckland Council Group’s assets, both with frequency of revaluations and financial impacts.

Aside from the treatment of the revaluation reserves in equity, we agree to the treatment of the net residual amount in cases of amalgamation under common control and not under common control. Accumulated funds, for example, are the result of the entity’s operations while accumulated revaluation reserves are changes in the movement of the balance sheet items that are being carried forward to a resulting entity. It is therefore appropriate to apply different treatments for these two in the modified pooling of interests method.

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?

Auckland Council’s response

We support and agree with the use of the acquisition method of accounting.

Other comments:

- There’s a typo error in page 14 paragraph 33 -The resulting entity shall not recognize any taxation items that are forgiven as a result of the acquisition **amalgamation**.
- Page 21, paragraph 74 is still using the probability approach as a recognition criteria - *How does this compare to the proposed NZ conceptual framework where the recognition principle is more subjective based on the elements and qualitative characteristics.*
- Share based payment
This is a comment specific to the XRB. Does share based payments apply to the public sector entities in NZ? This standard only applies to the entities that are partly listed, where the Crown still hold a majority share (e.g. the power generating companies such as Meridian, Mighty River Power and Genesis and Air New Zealand). These entities apply NZ IFRS not PBE standards. Public benefit entities currently do not have a PBE Standard equivalent for share based payments.
- Disclosure requirements for acquisition accounting
In cases where no consideration is transferred, we suggest adding a disclosure that a loss on acquisition was recognised instead of goodwill with a similar requirement for a bargain purchase per paragraph 118 (n).