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NEW ZEALAND INSTITUTE OF CHARTERED ACCOUNTANTS

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Email: edcomments@ifac.org

Dear Stephenie

ED 41 Entity Combinations from Exchange Transactions

The Financial Reporting Standards Board (FRSB) of the New Zealand Institute of Chartered Accountants is pleased to submit its comments on ED 41 *Entity Combinations from Exchange Transactions*. These comments are set out in an Appendix to this letter.

The FRSB supports the scope exclusion relating to amalgamations of municipalities or a restructuring of activities, but only on the grounds that the IPSASB has not yet discussed the specific public sector issues that arise from these types of entity combinations.

If you have any queries or require clarification of any matters in this submission, please contact Vanessa Sealy-Fisher (vanessa.sealy-fisher@nzica.com) in the first instance, or me.

Yours sincerely

Joanna Perry

Joanna Perry
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Appendix – FRSB comments on ED 41 Entity Combinations from Exchange Transactions

Scope

1. The FRSB supports the scope exclusion relating to amalgamations of municipalities or a restructuring of activities, but only on the grounds that the IPSASB has not yet discussed the specific public sector issues that arise from these types of entity combinations and, therefore, the appropriate accounting treatment for these amalgamations.

2. The FRSB notes that an amalgamation of municipalities or a restructure of activities are identified as non-exchange transactions and that the specific public sector issues which arise from these types of combinations have not yet been examined in detail. The FRSB encourages the IPSASB to progress the second component of its entity combinations project in order that requirements for amalgamations of municipalities can be developed.

3. The FRSB considers that the requirements of IFRS 3 may be appropriate for some non-exchange entity combinations, particularly those where the combination has been willingly entered into by the various entities. If two or more entities agree to combine because they consider there are benefits from doing so, then the recognition of a gain on acquisition may be appropriate. If an entity applying IPSASs acquired the assets and liabilities of another entity in a transaction which did not meet the definition of an entity combination, then it would recognise non-exchange revenue in accordance with IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. The FRSB considers that the IPSASB should be able to justify any difference in the treatment of gains from asset acquisitions and gains from entity combinations.

4. The FRSB also considers that it may be difficult to clearly distinguish between exchange and non-exchange entity combinations. There may be situations in which it is difficult to identify whether any consideration has been provided as part of the transaction. For example, in a local authority restructuring, there may appear to be no consideration. However, if the ratepayers of each local authority being acquired by a new combined local authority become ratepayers of the new entity, it could be argued that they have received an ownership interest in the new entity as consideration for their ownership interest in the previous entities. The FRSB invites the IPSASB to consider these issues and whether it is possible to provide guidance on assessing the existence of consideration in such situations.

Clarify scope examples

5. The FRSB recommends that the examples in paragraphs AG1 and AG2 (shown below) be clarified.

> AG1. This Standard applies to a transaction or other event that meets the definition of an entity combination arising from an exchange transaction. For example, a Federal government acquires an operation which is capable of being conducted and managed for the purpose of providing a return. The Federal government acquires an 82% shareholding directly in exchange for consideration transferred of CU892 million, as set out below.
>
> AG2. Another example of an entity combination arising from an exchange transaction is as follows: Province A acquires a charitable hospital which is owned and run by the Order of Grey Nuns, for providing hospital services to the disadvantaged in the community. Province A acquires all of the hospital's activities, assets and liabilities directly in exchange for consideration transferred of CU100 million, as set out below.

6. The FRSB considers that paragraph AG1 should explicitly state that the consideration transferred by the Federal government is approximately equal to the value of the shareholding acquired. This is the reason why the transaction falls within the scope of the proposed Standard. The fact that the operation acquired is capable of being conducted and managed for the purpose of providing a return is not relevant to determining whether the transaction falls within the scope of the proposed Standard. This statement could therefore be omitted.

7. The FRSB considers that paragraph AG2 should explicitly state that the consideration transferred by Province A is approximately equal to the value of the hospital acquired. The FRSB also considers that the example should state that the hospital's activities, assets and liabilities meet the definition of an operation in the proposed Standard.

Title of forthcoming IPSAS

8. It is unclear from the title of ED 41 that the proposed Standard applies to the acquisition of operations by an acquirer. Although the definition of 'entity combination' in Appendix A refers to the acquisition of one or more operations, an entity is required to read the definitions to determine that the proposed Standard applies to the acquisition of operations.

9. The FRSB is of the view that entities should be able to identify from the title of the proposed Standard that it applies to the acquisition of operations as well as the acquisition of an entity. This could be achieved by naming the proposed Standard 'Combinations of Operations from Exchange Transactions'.

Reverse acquisitions

10. IFRS 3 includes guidance on accounting for reverse acquisitions. ED 41 does not include this guidance and states (in paragraph BC8) that the usual drivers for a reverse acquisition, such as a back door listing, do not exist for public sector entities.

11. The FRSB considers that the guidance from IFRS 3 on reverse acquisitions should be retained in the proposed Standard as long as there is no conflict with other requirements in IPSASs because there is no public sector-specific reason to omit it.

Share-based payment awards

12. IFRS 3 includes guidance on the measurement of share-based payment awards where an acquirer replaces the acquiree's share-based payment award with another award. ED 41 does not include this guidance and states (in paragraph BC7) that public sector entities do not award share-based payments.

13. The FRSB agrees that the replacement of an acquiree's share-based payment award with another award by an acquirer applying IPSASs would be uncommon, but considers that this could occur. For example, if a government acquired a commercial operation which had an existing share-based payment award. The FRSB therefore considers that the guidance on share-based payment awards should be retained in the proposed Standard as long as there is no conflict with other requirements in IPSASs.

Definition of 'entity combination'

14. The definition of 'business combination' in IFRS 3 includes 'true mergers' and 'mergers of equals' so that such combinations fall within the scope of IFRS 3. The definition of 'entity combination' in Appendix A of ED 41 contains no reference to mergers.

15. The FRSB suggests that the sentence from the definition of business combination regarding mergers be included in the forthcoming IPSAS so that such transactions fall within the scope of the Standard.