

12 February 2019

Warren Allen
Chief Executive
External Reporting Board
PO Box 11250
Manners Street Central
Wellington 6142

Dear Warren

NZASB Exposure Draft 2018-4 – PBE Combinations (PBE IPSAS 40)

We appreciate the opportunity to provide comments to the New Zealand Accounting Standards Board on ED 2018-4 PBE Combinations.

In summary, we are very supportive of the NZASB issuing a Standard on PBE Combinations and we believe that the approach taken by the IPSAS Board in IPSAS 40 would result in sensible accounting in the public sector. We do however have some significant concerns about some of the extensive changes that the NZASB is proposing to make to the content of IPSAS 40 as issued by the IPSAS Board.

Note that our views are based on our knowledge and experience of public sector accounting and public sector combinations and we have focussed on the consequences for the public sector in forming our responses to the ED.

We set out our views in the attached document, which also provides our responses to the specific questions posed by the NZASB.

If you would like to discuss any of our comments, please phone me on 021 222 6107 or email me at robert.cox@auditnz.govt.nz.

Yours sincerely



Robert Cox
Director and Head of Accounting
Audit New Zealand

Our responses to the questions in the Invitation to Comment

1 Do you agree with the changes (as listed below) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate.

- (a) Indicators relating to consideration
- (b) Definitions of equity interests and owners
- (c) Use of the term “new entity”
- (d) Applying the modified pooling of interests method
- (e) Presentation of financial statements and disclosures
- (f) Acquiring a non-cash-generating operation
- (g) Identifying an acquirer
- (h) Transition
- (i) Voluntary combination not under common control
- (j) Selection of the accounting policies by the resulting entity
- (k) Income taxes

Our comments in relation to each of the matters (a) to (k) of your question 1 set out in your question are below.

(a) Indicators relating to consideration

We disagree with all of the changes made in relation to the indicators relating to consideration (paragraphs 12 and AG26 to AG 31). We find the IPSAS 40 as issued by the IPSAS Board clear and workable for the public sector in this area. We are concerned that the NZASB’s amendments have resulted in a change in the outcome for scenario 6 in the illustrative examples from an amalgamation to an acquisition. This suggests the changes could result in a substantive divergence from IPSAS.

The NZASB’s rationale for changes to this indicator, as we understand them from the invitation to comment paper, seems in part to be based on a concern that a donated operation should be able to be accounted for as an acquisition. In our opinion, the unamended IPSAS 40 already dealt with this adequately by requiring the reasons for no consideration to be considered (paragraph AG30) and also by including a specific example that a bequest of an operation may be acquisition (paragraph AG29).

Rather than the extensive changes made in relation to this indicator, we suggest the concerns the NZASB may have could have been addressed by adding in another specific guidance example from a NFP context. Also illustrative example scenario 6 could be amended to include further assessment of the reasons for no consideration and possibly assessment of the “additional matters” in paragraph 14 before concluding. A conclusion that this scenario could be either an acquisition or an amalgamation depending on the specific circumstances could be appropriate.

(b) Definitions of equity interests and owners

We are comfortable with these changes.

(c) Use of the term “new entity”

We consider the revised requirements are clearer than the original IPSAS document in this aspect.

(d) Applying the modified pooling of interests method

We disagree with the changes to paragraph 21 and 23.

The guidance about restructuring costs following amalgamations in paragraph 23 is useful (and almost identical to the content in paragraph 65 for restructuring costs following acquisitions) and it is unclear why it has been deleted.

Paragraph 21 as originally drafted appears to limit the recognition of assets and liabilities to those previously recognised by the combining entities. This appears sensible. The NZASB’s changes suggest that under PBE IPSAS 40 additional assets and liabilities can be recognised in an amalgamation, which cannot be recognised under IPSAS 40. If so, this change should be made clearer and the types of assets and liabilities that should/could be recognised discussed. If this change is driven by any concerns about entities that have previously used tier 3 or 4 standards, we suggest that this is dealt with in a different way.

We are generally comfortable with the proposed changes to paragraphs 20.1, AG50.1, AG50.2. We suggest that AG50.2(c) should be amended to refer to the accounting policies of the new reporting entity, as it is possible that the combining entities previously had inconsistent accounting policies. This change would also be consistent with the requirement of paragraph 27.

(e) Presentation of financial statements and disclosures

We agree with the NZASB’s proposals in this regard (paragraphs 50 to 54 and AG64).

(f) Acquiring a non-cash-generating operation

We disagree with the NZASB’s amendments to IPSAS 40 (and PBE IPSAS 26) in regard to acquisition of a non-cash generating operation that results in a reduction in net outflows of the acquirer. We consider that a better option than the IPSAS Board’s approach (allocate to entire entity) or the NZASB’s approach (expense) would be to allocate the goodwill to the cash-generating units that are expected to benefit from the combination (as per existing PBE IPSAS 26 paragraph 90.1).

(g) Identifying an acquirer

The inclusion of content from PBE IFRS 3 paragraph B15(c) and (d) has merit. However paragraph AG14 is not about identifying an acquirer; it is about identifying whether one entity has gained control over another. We suggest that the term “acquirer” is changed as it implies acquisition, whereas the guidance in AG14 can be relevant to combinations that may either amalgamations or acquisitions.

We disagree with the amendments made to paragraph AG17. We consider this paragraph as drafted by IPSAS Board was clear in meaning. The amendments make it less clear. We do not consider any amendment is required to AG17 to address B15(c) and (d) of PBE IFRS 3.

(h) Transition

We agree with the proposed transitional provisions.

(i) Voluntary combination not under common control

We are comfortable with new paragraph AG17.1 and new scenario 15.

(j) Selection of the accounting policies by the resulting entity

We agree with the NZASB's proposals in this regard (paragraphs AG54.1, AG54.2).

(k) Income taxes

We are comfortable with these changes. We note however that the heading above paragraph 78 is "Income taxes (where included in the terms of acquisition)". The new paragraphs 79.1 and 79.2 apply whether or not tax is covered in the terms of acquisition, so may need a separate heading.

- 2 **Do you agree with the changes (as listed in Table 2 above) made by the NZASB in developing the proposed PBE IPSAS 40? If not, please explain why not and identify what you think would be more appropriate.**

We disagree with many of these changes. Our detailed response is in appendix one.

- 3 **Do you agree with retaining paragraphs 13(b) and AG36 in the proposed PBE IPSAS 40? If you disagree, please provide reasons.**

Yes we strongly support retaining paragraphs 13(b) and AG36. We note that reorganisations of local authorities under Schedule 3 of the Local Government Act 2002 may involve a poll of electors in the affected area. Therefore this indicator is of direct relevance to New Zealand local government.

- 4 **Do you agree with the concessions and associated RDR paragraphs in the proposed PBE IPSAS 40? If you disagree, please provide reasons and indicate any additional concessions or RDR paragraphs that you consider would be appropriate.**

Yes, we agree with the concessions and associated RDR paragraphs.

- 5 **Do you agree with the proposed effective date of 1 January 2021, with early adoption permitted? If you disagree, please provide reasons.**

We agree with the NZASB's proposed approach.

- 6 **Do you have any other comments on the Exposure Draft?**

Our summary view is that we consider that the NZASB has made too many changes to the core IPSAS standard.

While some of the NZASB's changes have improved the understandability or consistency of the original IPSAS document, there are many changes that in our opinion do not significantly improve the standard and are not necessary for the standard to work effectively in the New Zealand environment.

We reviewed the XRB document "Policy Approach to Developing the Suite of PBE Standards" (updated December 2018), as we believe this is the document that should guide the NZASB in its consideration of standards issued by the IPSAS Board. In our view, some of

the amendments being proposed do not meet the amendment circumstances described in paragraph 24 of this policy document.

(a) Amend a recently issued or newly amended IPSAS in the process of adoption in New Zealand. Examples of possible amendments include:

(i) improving the quality of the IPSAS in the New Zealand context by, for example, adding guidance or making changes to enhance the clarity and consistency of the requirements to enable public sector PBEs and NFP PBEs to apply the standard consistently;

(ii) adding guidance to assist NFP PBEs in applying the standard, given that the standard has been developed for application by public sector PBEs;

(iii) amending as necessary to maintain the coherence of the suite of PBE Standards;

(iv) excluding options that are not relevant in the New Zealand context; or

(v) amending the scope of an IPSAS if the IPSAS conflicts with a legislative requirement, or a legislative requirement addresses the same issue for public sector entities. However, in these circumstances, it may be appropriate to adopt the IPSAS for NFP PBEs.

Audit New Zealand is supportive of the NZASB making changes to the IPSAS standards where it is necessary for the standards to best meet the needs of the New Zealand public and not-for-profit sectors and we support the approach set out in the XRB policy document referred above.

We believe some of the substantive changes made by the NZASB are not necessary and we do not support extensive editorial changes to the IPSAS issued standards.

We are also concerned that too much amendment to the requirements of the IPSAS standards will make it difficult for the New Zealand public sector to explain the standards they are applying to international bodies. Currently the Financial Statements of the Government of New Zealand state:

*These financial statements have been prepared in accordance with Public Sector PBE Accounting Standards (PBE Standards) – Tier 1. These standards are **based on** International Public Sector Accounting Standards (IPSAS). [emphasis added].*

At some point in the future, we may be asked to explain what is meant by “based on” or to explain the differences between New Zealand’s PBE IPSAS and IPSAS as issued by the IPSAS Board. The more changes that are made, the harder it becomes to answer this question.

We consider that all new substantive differences to the original IPSAS need to be well justified and explained in each new Standard’s Basis for Conclusions and we are pleased that the NZASB has included a discussion of some of the more substantive changes in the Basis for Conclusions. However, the NZASB has proposed some other potentially substantive changes that are not discussed in the Basis for Conclusions.

We would also prefer that wherever possible substantive changes to the original IPSAS were presented within the Standard in a way that makes them clearly identifiable to the reader.

Appendix 1: Table of detailed responses to consultation question 2

Paragraph(s)	XRB Comments	Audit NZ comments
5	Aligned the definition of an operation with the definition of a business in PBE IFRS 3.	Agree.
16(c), 21, 26, 28, 30, 41, 42, AG54, IE166, IE173, IE174	Removed reference to “identifiable” assets in the guidance for amalgamations. This is a defined term that is specifically linked to the recognition of intangible assets. The use of the word identifiable is appropriate under acquisition accounting which requires the separation of identifiable intangible assets but does not seem necessary when discussing amalgamations.	Disagree. We do not support this change without a clear explanation in the basis for conclusions of the standard explaining why the change has been made and the consequences (if any) of it. We find it unclear from the ED what deleting the term “identifiable” for amalgamations and retaining it for acquisitions is intended to achieve. If the intention of the proposal is that PBE amalgamations can recognise some non-identifiable assets that cannot be directly recognised in an acquisition, then this should be made clearer. The one example we thought of might be the treatment of goodwill previously recognised by a combining entity in an amalgamation (although this is covered by AG60).
20	Deleted the example because the necessary information about determining the date control is obtained is in the other sentences in paragraph 20.	Disagree. The example is useful and is not elsewhere in paragraph 20.
21, 26	Clarified that the recognition and measurement principles of an amalgamation are subject to the exceptions in paragraph 31 of the proposed PBE IPSAS 40.	Disagree. Paragraph 21. Although the reference to the exceptions in paragraph 31 may be helpful, the remaining editorial changes are not necessary. It is unclear why the phrase “that are recognized in the financial statements of the combining operations” has been deleted. Does this mean under PBE IPSAS 40 additional assets and liabilities can be recognised in an amalgamation, which cannot be under IPSAS 40? If so, this change should be made clearer.
24	Changed the requirement to allow for situations where the resulting entity might be required to adopt a different classification or designation in order to comply with PBE Standards. IPSAS 40 does not allow for that possibility.	Agree.
37	Clarified that the net amount from the total of sub-paragraphs (a)–(c) is recognised in net assets/equity.	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS.

37(a)	Provided clarity as to which combining operations are being referred to.	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS.
39(b)	Clarified that the existing net assets/equity balances, such as reserves of the combining operations can be retained and shown separately by the resulting entity.	Disagree. The editorial change is less clear than the original text.
87	Clarified that the recognition of goodwill in an acquisition where no consideration is transferred is limited to situations where achieved through changes in voting rights, by contract alone or similar circumstances.	Disagree. It is not clear to us that the IPSAS Board intended this paragraph to be limited to the circumstances in paragraphs 101 and 102.
94	Removed the reference to paragraph 86 because that paragraph provides requirements on the recognition of goodwill. Paragraph 94 does not permit the recognition of goodwill.	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS. Note that the reference to paragraph 86 makes sense as the final sentence of paragraph 86 deals with recognition of the ‘excess’ in surplus or deficit.
106	Clarified that increases or decreases in goodwill are subject to the requirements for recognition of goodwill in paragraph 86.	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS.
AG4	Added examples of inputs and processes from PBE IFRS 3 paragraph B7. Aligned the description of an output with PBE IFRS 3 paragraph B7.	Agree.
AG23	Clarified that there might be circumstances in which there are controlling entity/controlled entity relationships after an amalgamation and added an example to illustrate this.	Agree. Useful additional guidance.
AG24	Removed the discussion of the types of benefits or service potential obtained because this does not affect the classification of the combination.	Agree. Meaning of original IPSAS text not clear to us.
AG25	Removed paragraph because it repeats matters already covered in paragraph AG21.	Disagree. AG25 is quite different to AG21.
AG43, AG44, table in AG45	Deleted the sentence about future cash flows associated with assets and liabilities as other considerations tend to be more important in the public sector and NFP sector context.	Disagree. The sentence in AG43, AG44 and AG45 about future cash flows is relevant and useful guidance in some public sector circumstances.
AG44, table in AG45	Added “where paid” because not all investments would have involved consideration.	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS.
AG53	Removed paragraph because it was not necessary and could create confusion.	Disagree. The paragraph is technically correct. Agree it is not that important but is that reason enough to delete it.
AG54	Deleted the last sentence because it does not seem to be consistent with paragraphs 26–27 and therefore could create confusion.	Disagree. AG54 continues the discussion from AG53 and is technically correct. We agree the wording could be improved.
AG65, AG113	Removed paragraphs because regulators always have the option to require additional information and these paragraphs are not establishing a requirement.	Disagree. These guidance paragraphs are technically correct and there is no need to make this change from IPSAS 40.

AG66	Replaced “public sector entity” with “unlisted entity” to allow for application by both NFPs and public sector entities.	Agree.
AG79	Added an example of the acquirer’s trade name (under a network and partner agreement) to broadly align with PBE IFRS 3 paragraph B35.	Agree.
IE69, IE79, IE83, IE127, IE136	Replaced the word “seller” with references to either the owner of the acquired operation or the acquired operation because the combination does not involve the actual sale of the acquired operation.	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS. We consider the intent was to use the exact words from AG26 (which uses “seller”) to demonstrate the application of that paragraph.
IE145, IE154	Removed reference to compensating the seller for giving up an entitlement to the net assets of an operation because both examples are bailouts where the seller receives no compensation and there is a transfer of net liabilities rather than net assets	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS. We consider the intent was to use the exact words from AG26 (which uses “seller”) to demonstrate the application of that paragraph.
IE154	Removed the phrase “...analogous to paying consideration” because it was not clear how taking on net liabilities is analogous to paying consideration. Added the phrase “...no payment of consideration is necessary” because the acquirer is taking on net liabilities and there is no payment for the acquired operation.	Editorial change. Not necessary, but does no harm other than diverging from “pure” IPSAS.