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25 January 2019

### ***Exposure Draft NZASB 2018-4: PBE IPSAS 40 PBE Combinations***

Dear Warren

The New Zealand Accounting Standards Board (NZASB) has sought comments on *Exposure Draft NZASB 2018-4: PBE IPSAS 40 PBE Combinations* (ED 2018-4). PwC New Zealand is pleased to present its comment letter.

We agree with the proposals in ED 2018-4 and the changes made by the NZASB in developing the proposed standard (for the reasons provided in the Invitation to Comment and the Basis for Conclusions supporting ED 2018-4). However, we do have some recommendations as set out below.

#### ***Indicators that a combination is an amalgamation***

Regarding the indicators that provide evidence that a combination is an amalgamation, we recommend that the NZASB consider providing application guidance on how the extent of consideration payable may affect the assessment of whether a combination is an amalgamation instead of suggesting that only the absence of consideration paid to compensate those with an entitlement to the net assets of a transferred operation may provide evidence that the combination is an amalgamation.

For example, based on our experience in practice, consideration set at an amount equal to the fair value of the net assets of the combining operation may provide evidence that the combination is an acquisition. Conversely, if the consideration is set at an amount equal to the existing book values of the combining operation, it may provide evidence that the combination is an amalgamation.

#### ***Expensing of goodwill arising on the acquisition of a non-cash generating operation***

We recommend that the NZASB provide, in the Basis for Conclusions, greater explanation of its decision to require that goodwill arising on the acquisition of non-cash generating operations be expensed immediately.

Addressing the difficulties and cost that the NZASB envisaged preparers may encounter and PBEs may incur in attempting to apply the approach adopted in IPSAS 41 *Public Sector Combinations* may enable greater understanding of the NZASB's considerations. This may facilitate greater appreciation for the practical option proposed by the NZASB of simply expensing this goodwill, which otherwise may appear to be an unnecessarily extreme approach.

### ***Need to distinguish between cash and non-cash generating operations acquired***

A combining entity may consist of more than one operation, one of which may be cash generating and the other non-cash generating (for example a public hospital with a private hospital wing where patients in the private wing pay market price for hospital services). In this scenario, based on our understanding of the proposed requirements, the PBE that obtains control of the combining entity may be required to break down a combining entity into its cash-generating and non-cash generating operations to effect the appropriate acquisition accounting (and immediately expense the goodwill arising in relation to the non-cash generating operation).

Preparers may not be fully aware that the potential unit of account for an acquisition is at a level lower than the combining entity. Particularly since, when accounting for acquisitions under PBE IFRS 3 *Business Combinations*, the acquisition accounting is applied at the level of the entity being acquired (rather than at a lower level such as at the level of the cash-generating units making up the entity).

To provide more clarity, we recommend that the NZASB provide an example of accounting for a combination with an entity that contains both cash-generating and non-cash generating operations.

### ***Carrying amounts used in accounting for an amalgamation***

Where a combining operation has previously been acquired in an acquisition the carrying amounts of the combining operation's assets and liabilities in its separate financial statements may be different to the carrying amounts of those assets and liabilities in the controlling entity's consolidated financial statements as a result of adjustments made in the acquisition accounting by the controlling entity.

ED 2018-4 proposes that, where these two entities are amalgamated, the carrying amounts used in accounting for the amalgamation should be the carrying amounts in the financial statements of the combining entities rather than the carrying amounts included in the controlling entity's consolidated financial statements.

However, in our experience, where such an amalgamation occurs between entities under common control, it is more common for the amalgamation to be accounted for using the carrying amounts of assets and liabilities of the acquired entity from the consolidated financial statements of the highest entity that has common control for which consolidated financial statements are prepared. These amounts include any goodwill and other fair value adjustments recorded at the consolidated level in respect of the acquired entity. This is because the transaction is under the control of that entity, and it is a portion of the controlling entity that is being moved within the group as a result of the transaction.

In particular, the proposal in ED 2018-4 that the carrying amounts used should be the carrying amounts in the financial statements of the combining entity may cause a noticeable change where a subsidiary is amalgamated into a parent. For example, a PBE parent may acquire company A and apply acquisition accounting thereby adjusting the assets and liabilities of company A to fair value. After the acquisition, the PBE parent's group financial statements would include the company A's assets and liabilities at fair value. In a subsequent period the PBE parent may decide to amalgamate company A's operations into the operations into that of the PBE parent. If the PBE parent accounted for the amalgamation using the carrying values of the company A's assets and liabilities included in the group financial statements the amalgamated entity could simply report the same carrying amounts that would have been reported in the PBE parent's consolidated financial statements.

If the PBE parent is required to use the carrying amounts in the financial statements of Company A, the amounts reported in the amalgamated entity's financial statements would not be comparable to the those previously reported in the PBE parent's group financial statements that would have included fair value adjustments on the acquisition of Company A.

Since the requirement to use the carrying amounts in the financial statements of the combining operations may be a change from practice in New Zealand, we suggest that the NZASB consider providing in its Basis for Conclusions rational for prescribing this approach.

***Combining operations that have not previously applied PBE Standards***

Where the entity resulting from a combination is a new reporting entity and one or more of the combining operations have not previously applied PBE Standards prior to the amalgamation, it is proposed that the resulting entity first apply XRB A1 *Application of the Accounting Standards* to determine the appropriate tier of reporting for the resulting new reporting entity.

Since the new reporting entity is an amalgamation of the combining operations and likely larger than any of the combining entities alone, it is possible that the tier in which the new reporting entity falls may be a different (higher) tier than that in which any of the combining entities fell. However, paragraph AG50.2(c) seems to suggest that the new reporting entity should still apply the policies applied by any of combining entities that applied PBE Standards prior to the amalgamation, even if they reported in accordance with a different tier to that in which the new reporting entity falls.

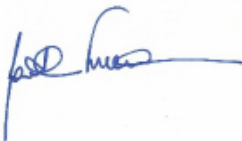
We recommend that paragraph AG50.2(c) be amended to clarify that the new reporting entity is required to apply the same accounting policies as those applied by any combining entities that applied PBE Standards prior to the amalgamation unless a change in policy is required to comply with the requirements of the tier in which the new reporting entity falls.

***Editorial changes***

We note that paragraph AG 10 of ED 2018-4 should read as follows: 'Where a party to a PBE combination gains controls of...'

Should you wish to discuss the above, please do not hesitate to contact Richard Day on (09) 355 8824.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Jonathan Freeman', written over a horizontal line.

Jonathan Freeman  
Partner  
Assurance Leader